Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1997

DRAGO DAIC INTERESTS, INC.,

Petitioner,

v.

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

I.

Did the United States Fifth Circuit Court of Appeals err when it rendered its opinion purporting to adversely decide the rights of entities not before the Court of Appeals, the District Court or the Arbitration Panel (i.e. who were not parties to any of the proceedings below) and over which neither the Fifth Circuit nor the forums below had in personom jurisdiction on an issue not properly before the arbitration panel, the District Court or the Fifth Circuit Court of Appeals?

Did this violate such entities' Fifth Amendment rights under the United States Constitution to notice and a hearing?

Did this violate the Federal Arbitration Act in that the arbitrators exceeded their powers and ruled on a matter not submitted?

II.

Did subjecting entities who did not agree to arbitration to the outcome of an arbitration to which such entities were not parties ruling that the rights of such entities were adversely affected on grounds directly contradictory to the terms of the contract exhibit a manifest disregard of law?

Should manifest disregard of law be firmly recognized as a basis for challenging an arbitration award?

PARTIES, PARENT COMPANIES AND NON-WHOLLY OWNED SUBSIDIARIES

The parties to this proceeding are contained in the caption. Drago Daic Interests, Inc. has no parent corporations and no non-wholly owned subsidiary corporations.

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CITATIONS OF OFFICIAL AND UNOFFICIAL REPORTS

The opinion of the Fifth Circuit Court of Appeals is contained at 138 F.3rd 160 (1998). The unpublished District Court's decision occurred on the 18th day of March, 1997. The arbitration award was issued on the 9th day of February, 1996. *See* Appendices A, B, C, D and E.

BASIS OF JURISDICTION

The Fifth Circuit Court of Appeals' opinion was issued on the 31st day of March, 1998. A Motion for Rehearing of such opinion was denied on the 29th day of April, 1998. *See* Appendix G. This Court has jurisdiction to review on a Writ of Certiorari pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED IN THE CASE

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law; . . .

The Federal Arbitration Act, 9 U.S.C. § 10 provides in pertinent part as follows:

> (a) In any of the following cases the United States Court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration –

* * *

> (4) Where the arbitrators exceeded their powers . . .

The Federal Arbitration Act 9 U.S.C. § 11 provides in pertinent part:

> In either of the following cases the United States Court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration –
>
> * * *
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

STATEMENT OF THE CASE

In January of 1990 Nauru Phosphate Royalties (Texas), Inc. (a Delaware corporation) (hereinafter "Nauru") entered into a Development Agreement with Drago Daic Interests, Inc. (a Texas corporation) (hereinafter "DDI") to develop a tract of land in Montgomery County, Texas comprising approximately 668 acres into what became a master planned community called Bentwood. Nauru purchased the land from an investment joint venture composed of Drago Daic, Trustee and a limited partnership named Montgomery 666, Ltd. (hereinafter "the Noteholders") for $5,000,000.00 in cash and an $8,000,000.00 cash flow promissory note secured by the project. The promissory note payable by Nauru to the

noteholders incorporated the Development Agreement but the Development Agreement was only signed by the noteholders as to Section 3.7 (lien releases upon sale of the property by Nauru to a third-party) and Article 5 (mechanics of distribution of revenue to, among other things, pay the promissory note). The arbitration clause was contained in Section 13 of the Development Agreement but the noteholders did not sign such Agreement as to, or otherwise agree to, arbitration. *See* Appendix H (containing a copy of Section 13 – Dispute Resolution relating to arbitration obligations and the signature pages of the agreement showing that DDI and Nauru signed the agreement without reservations but that the noteholders only signed the agreement "with respect to Section 3.7 and Article 5").

The mechanics of distribution of revenue, including payment of the promissory note, is contained in Section 5 of the Development Agreement utilizing definitions contained in Section 1 of the Development Agreement. The procedure is to apply all revenue in a given calendar year to all of the expenses of Nauru in the same calendar year (under Section 7 of the Development Agreement, Nauru was to fund all monies necessary for the development of the project). If expenditures exceeded revenues, no excess was left over. If revenue exceeded expenditures, Nauru received the amount of its expenditures and any remainder in excess of expenditures, if any, was applied to the promissory note (with a maximum payment in any year on the note of $1.6 million). This was to continue until the note was fully paid or the project was fully sold, whichever came first. In the event of a bulk sale of all or part of the project, Section 5.4 of the Development Agreement

mandated a note payment based upon then existing amounts of expenditures versus unpaid promissory note balance. Once the promissory note and all expenditures were paid, profits would be available under the agreement for distribution to Nauru (77 1/2%) and DDI (22 1/2%). DDI would not share in promissory note payments and the noteholders would not share in the profits. If Nauru became dissatisfied with DDI's performance and terminated DDI with or without cause, the note was to remain in place until fully paid or the project sold, whichever came first. Though the note was obviously to be paid from revenues of the project, the note payment obligations by Nauru were not legally dependent upon DDI remaining as developer of the project or DDI's performance. *See* Appendix H containing the termination provisions of the agreement wherein (page 61) it is provided:

> The termination of this agreement, with or without cause, shall in no way accelerate or otherwise modify seller's right to receive payments of principal under the promissory note in accordance with the priority for cash flow distribution as set forth in Section 5.1.

Development of the project began in 1990 and continued into 1995. During this period of time all amenities (club house, golf course, landscaping, drainage improvements, utility districts, etc.) were substantially completed and approximately $1.1 million of lot inventory had been sold to builders. However, during this period of time, DDI had become immediately dissatisfied with Nauru's timeliness of funding monetary requests and decision making. Nauru had become dissatisfied with the costs and expenses. The noteholders had become dissatisfied

from the lack of revenue (the noteholders had been paid no sums on the note given in exchange for their land). In 1995, the noteholders made demand upon Nauru for promissory note payments and instituted a lawsuit in state district court in Montgomery County, Texas against Nauru and a subsidiary to collect two payments on the note claiming that but for Nauru's actions on the project, cash flow would and should have been sufficient in 1993 and 1994 to have generated two promissory note payments in the amount of $1.6 million each. Nauru terminated the agreement with DDI and instituted the arbitration proceeding against DDI generally claiming fraud on the part of DDI in inducing Nauru to enter into the transaction and to continue with development as well as for various categories of cost overruns. Nauru also claimed against DDI for indemnity for anything Nauru might have to pay to the noteholders on the promissory note but did not claim in its complaints that the note was invalid for any reason or that the noteholders had in any way breached their obligations. DDI counterclaimed in arbitration claiming for its share of the 22 1/2% of profits that would have been generated at the conclusion of the project. The noteholders never had arbitration demanded of them, were not parties to the arbitration between Nauru and DDI, and did not participate in such arbitration. Nauru never sought to abate the noteholders' lawsuit arguing the noteholders were required to arbitrate. The arbitrators issued an award in which they denied all of Nauru's claims of fraud, denied DDI's counterclaim for lost profits and granted a portion of Nauru's claims for certain categories of cost overruns and attorney's fees (in the approximate sum of $1,800,000). Excluding almost

$400,000.00 in attorney's fees, the monetary portion of the award amounted to a cost overrun of approximately 5% of Nauru's total investment in the project. However, the arbitration award also found that the termination of DDI was with cause and that thus Nauru had no liability for the payment of the promissory note to the noteholders who were not parties to and did not participate in the proceeding (at all relevant times, the noteholders had been prosecuting their state district court action in Montgomery County against Nauru). Nauru filed an action in federal district court to confirm the arbitration award relying on diversity jurisdiction pursuant to 28 U.S.C. § 1332. The district court not only confirmed the arbitration award relating to the promissory note but went further and held that the arbitration award confirmation was binding on the non-party noteholders. The Fifth Circuit affirmed.

REASONS FOR GRANTING THE WRIT

I. THE UNITED STATES COURT OF APPEALS HAS ENTERED A DECISION IN CONFLICT WITH THE DECISION OF ANOTHER UNITED STATES COURT OF APPEALS ON THE SAME IMPORTANT MATTER.

The Fifth Circuit Court of Appeals not only affirmed the District Court's confirmation of the arbitration award but purported to hold that the award denying liability on the promissory note to the noteholders who were not parties to and did not participate in the arbitration was binding on the noteholders. This is in conflict with other

decisions of other United States Courts of Appeal including *Orian Shipping and Trading Company v. Eastern States Petroleum Corp. of Panama S.A.*, 312 F.2d 299 (C.A. NY 1963), *cert. denied*, 373 U.S. 949; *NCR Corp. v. Sac-co, Inc.*, 43 F.3rd 1076 (6th Cir.), *cert. denied*, 116 S.Ct. 272 (1995); *Eljer Mfg., Inc. v. Kowin Development Corporation*, 14 F.3rd 1250 (7th Cir.), *cert. denied*, 114 S.Ct. 2675 (1994); *International Brotherhood of Electrical Workers Local No. 265 v. OK Electric Company*, 793 F.2d 214 (8th Cir. 1986).

II. A UNITED STATES COURT OF APPEALS HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AND SANCTIONED SUCH A DEPARTURE BY A LOCAL COURT, AS TO CALL FOR AN EXERCISE OF THIS COURT'S SUPERVISORY POWER.

The decision of the Court of Appeals affirmed a confirmation of an arbitration award purporting to reach out and adversely decide the rights of entities not parties to the proceeding without giving such entities notice and an opportunity to be heard on the question of the adverse effect on their rights. It is fundamental that neither arbitration panels nor courts should have the power to adversely affect the rights of entities over which they have no jurisdiction. Even if jurisdiction might have otherwise existed upon joinder, the non-party entities are entitled to the right to be joined in whatever proceeding might be brought to attempt to adversely affect their rights.

III. THE UNITED STATES COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW IN A WAY THAT CONFLICTS WITH RELEVANT DECISIONS OF THIS COURT.

This United States Supreme Court has held on numerous occasions that due process requires notice and a hearing (and that lack of proper joinder by appropriate service even assuming entities were named voids any judgment purporting to adversely affect the rights of such entities). The decision of the Fifth Circuit Court of Appeals directly conflicts with this. *See, Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80 (1988); *Mullane v. Central Hanover Bank and Trust Company*, 339 U.S. 306 (1950); *Armstrong v. Manzo*, 380 U.S. 545 (1965); *Worldwide Volkswagon Corporation v. Woodson*, 444 U.S. 286 (1980); *Mathews v. Eldridge*, 424 U.S. 319 (1976); *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969); *Pennoyer v. Neff*, 95 U.S. 794 (1878).

IV. THE UNITED STATES COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL STATUTORY LAW IN A WAY THAT CONFLICTS WITH THE TERMS OF THE STATUTE.

Federal Arbitration Statute prohibits arbitrators from exceeding their powers and deciding on a matter not submitted. It exceeds the powers of arbitrators to decide a question in a manner that purports, by its own terms, to apply to and bind a non-party. The presence of the noteholders to whom the promissory note was payable is indispensible to a determination of legal liability on the promissory note and the matter was not, and could not

have been, submitted to arbitration in a way to bind the noteholders.

V. THE ARBITRATION AWARD AND THE DECISIONS OF THE LOWER FEDERAL COURTS ARE IN MANIFEST DISREGARD OF THE LAW.

This court should firmly recognize manifest disregard of the law as a basis for overturning an arbitration award. The arbitrators held the noteholders' rights were adversely affected by the performance and termination with cause of the developer, DDI. This is in direct contradiction to the terms of the written contract. The federal court purported to hold such decisions binding on non-parties who have never had notice and an opportunity for a hearing. This manifest disregard of the law should not be allowed to stand.

ARGUMENT AND AUTHORITIES

I. THE COURT ERRED IN HOLDING THE ARBITRATION AWARD AND DISTRICT COURT JUDGMENT APPLICABLE TO MONTGOMERY 666, LTD. AND DRAGO DAIC, TRUSTEE WHO WERE NOT PARTIES TO ANY OF THE PROCEEDINGS AND OVER WHICH THE COURT HAD NO JURISDICTION IN VIOLATION OF BOTH THE DUE PROCESS CLAUSE IN THE FIFTH AMENDMENT TO THE FEDERAL CONSTITUTION AND THE FEDERAL ARBITRATION ACT.

A. The noteholders were not parties.

It is an undisputed matter of record and referenced in every opinion relating to this matter that Montgomery

666, Ltd. and Drago Daic, Trustee (the noteholders) were not parties to the arbitration or the District Court proceeding and are not parties to this appeal. The decision of the Court (Appendix A) purports to reach out and deprive those parties of an $8,000,000.00 claim when those parties have not been joined in this proceeding, are not before the Court, and over whom neither the lower court nor the arbitration panel had personal jurisdiction. Even the arbitration award (Appendix E) did not purport to apply itself to entities that were not parties to the arbitration (such holding appeared for the first time at the District Court level). Any entity must be accorded notice and an opportunity to present their objections in a proceeding, (which has been consistently held to require making such entities a party to the proceeding and subjecting them to jurisdiction of a court by joinder and service of process), before such entity can be deprived of legal rights. Cases decided by this court have consistently held that due process requires this. *See, Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80 (1988); *Mullane v. Central Hanover Bank and Trust Company*, 339 U.S. 306 (1950); *Armstrong v. Manzo*, 380 U.S. 545 (1965); *Worldwide Volkswagon Corporation v. Woodson*, 444 U.S. 286 (1980); *Mathews v. Eldridge*, 424 U.S. 319 (1976); *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969); *Pennoyer v. Neff*, 95 U.S. 794 (1878). The number of Federal Circuit Court of Appeals cases, along with cases from numerous other jurisdictions so holding are quantitatively too numerous to cite. The undersigned is unaware of any case in the entire body of Federal or Texas jurisprudence that purports to deprive entities of significant legal rights and interests in a proceeding to which such entities are

not parties. Though it is not uncommon for litigants to seek to apply (in a later proceeding) a holding from an earlier proceeding to entities not parties to the earlier proceedings (giving rise to doctrines such as collateral estoppel, etc. – discussed later), any such attempt to hold an entity bound by a prior proceeding must be in a proceeding with notice and joinder of such entity so that it might have the opportunity to be heard. It is noted that numerous cases hold that an arbitration award is not applicable to non-parties and even attempts to join entities as parties so as to bind them following the conclusion of the arbitration is improper. *Orian Shipping and Trading Company v. Eastern States Petroleum Corp. of Panama S.A.*, 312 F.2d 299 (C.A. NY 1963), *cert. denied*, 373 U.S. 949; *NCR Corp. v. Sac-co, Inc.*, 43 F.3rd 1076 (6th Cir.), *cert. denied*, 116 S.Ct. 272 (1995); *Eljer Mfg., Inc. v. Kowin Development Corporation*, 14 F.3rd 1250 (7th Cir.), *cert. denied*, 114 S.Ct. 2675 (1994); *International Brotherhood of Electrical Workers Local No. 265 v. OK Electric Company*, 793 F.2d 214 (8th Cir. 1986).

The noteholders have not had any opportunity to present their case in this proceeding. No pleadings were ever directed to the noteholders, no party demanded arbitration of the noteholders, the noteholders filed no response, did not participate, introduced no documents or exhibits or evidence, were represented by no attorneys, called no witnesses, filed no motions, did no discovery, did not intervene, sought no relief and had no relief sought against them. Only presented here are what legal arguments might be available based on a record the noteholders had no part in compiling from a hearing in which they had no opportunity to participate. They had no

notice their rights might be in jeopardy. The arbitration provisions in the agreement (Appendix H), the Rules of the American Arbitration Association, (Appendix J) and, analogously, Federal Rules of Civil Procedure require that a complaint be made and served on the party from whom relief was sought. This was never done as to the noteholders. The cases are legion in all jurisdictions that lack of service voids a judgment even if an entity is named as a party and is aware that efforts are being made to litigate its rights. In this case the noteholders whose rights have been purportedly adversely affected were not even named, much less served with such process, as would give them reasonable notice that their rights might be in jeopardy.

No opinion or judgment in this matter has even described any recognized basis by which the noteholders might be bound by an arbitration award arising out of a proceeding in which they were not joined. The relationships described in the opinions below do not constitute any recognized form of privity or alter ego theory which would cause the noteholders to be bound. But most importantly, even if any recognized theory could be articulated, this must be sought in a proceeding in which such noteholders are joined with an opportunity to defend as opposed to preemptively adversely affecting their rights.

The opinions below describe various theories whereby it is argued that the noteholders are not due payments on the note from Nauru and that, thus, the noteholders' claim is not valid. It should be presumed that the noteholders disagree (and they have never been granted their day in court to present their case and to compile a record to rebut this). However, even if the

noteholders' case is unmeritorious (which is denied), such is irrelevant. "Where a person has been deprived of property in a manner contrary to the most basic tenets of due process, it is no answer to say that in his particular case due process would have led to the same result because he had no adequate defense upon the merits". *Peralta* at 86, 87.

Arguments have also been made that the noteholders were bound to arbitrate as a result of their suit seeking to enforce provisions of the Note and Development Agreement against Nauru. Setting aside that the noteholders only signed the respective agreements as to limited provisions (which did not include arbitration) (*see* Appendix H – signature page of the Development Agreement), it is undisputed that there is no provision anywhere that exempts any party from demanding arbitration of the noteholders should such entities so decide to arbitrate nor is there any provision that binds the noteholders to the outcome of an arbitration to which they were not joined and in which they did not participate. Whether the noteholders might have been determined to be required to arbitrate their disputes had any entity ever sought arbitration from the noteholders on the claims the noteholders were making in court is a different issue. The issue in this case is, given the undisputed fact that no one complied with the requirement of demanding arbitration of the noteholders and giving them an opportunity to defend their position, can they be bound by an arbitration in which they did not participate as the result of a decision in this proceeding to which they are not parties.

B. The noteholders were not represented.

It is argued that the noteholders can be bound if congruent and related interests (similar to privity) exist with DDI. The noteholders should have their day in court to rebut this. Further, DDI and the noteholders simply did not have congruent and related interests. Traditionally privity relationships included successors in title or interests in land, indemnitor/indemnities (such as insurance company to insured), beneficiaries of a trust administered by a trustee, or beneficiaries of an estate with executors, where the party held to be bound had the same legal interests as the party who litigated. Such does not exist in this case. The promissory note was not payable to DDI. DDI's claim was loss of its 22 1/2% profit interest to be paid at the conclusion of the development if the project made profits while the noteholders' claims were for payments on the note arising from cash flow in 1993 and 1994 – the noteholders' claims are not dependent upon whether any profits would ever be generated out of the projects and they are not entitled to any profits. The ultimate issues (profits from overall development versus cash flow in a given year) were different and would not arise out of identical facts. The relief sought by DDI in the arbitration and the noteholders in the state court case were different. Neither of the two sets of parties own an interest in the other. The rights themselves are not legally derivative since the noteholders' rights derive out of the sale of land and the promissory note Nauru gave the noteholders as partial consideration for the land as opposed to the interest of DDI for profits under the Development Agreement in consideration of services rendered in developing and selling the property.

Neither of the two entities' rights are legally dependent upon the other. Contrary to the implication in the court's opinion, the agreements simply do not make recovery of note payments out of cash flow legally dependent upon performance by DDI. If DDI wholly failed to perform or materially breached the agreement and was terminated with or without cause and favorable economic conditions caused significant yearly revenue over expenditures or if Nauru sold the project in bulk, the noteholders were entitled to be paid pursuant to the formulae set forth in Section 5.15.4 of the Development Agreement. The agreement specifically states this on Page 61 where it provides:

> The termination of this agreement, with or without cause, shall in no way accelerate or otherwise modify seller's right to receive payments of principal under the promissory note in accordance with the priority for cash flow distribution as set forth in Section 5.1.

The lower court cites no established legal theory for holding the noteholders in privity with DDI (in a proceeding which, as mentioned, they were not parties, and had no opportunity to participate). The cases cited in the court's opinion were decided on the basis of well recognized doctrines (*Sharp Properties* – sub-tenants rights derivative of prime tenant which is successors in interest to real estate; *Cecil's* – assumption by a sub-contractor of the obligations of, and indemnity of, a prime contractor which is indemnitor/indemnitee; *Amoco Cadiz* – 1) identical interests and 2) this case is not in point since the issue was whether a joined party was required to proceed to arbitration after notice when it would have an opportunity to participate in the proceeding).

Even more importantly, every case cited as support for the decision arises out of circumstances where an arbitration award is sought to be enforced against a non-party in a proceeding to which the non-party to the arbitration is joined and given an opportunity to make a record and resist the application of the prior arbitration award to such entity. This is a relatively common fact pattern discussed in numerous cases relating not only to arbitration but also judgments of courts and gives rise to the doctrines variously described as res judicata, collateral estoppel, estoppel by judgment, privity, alter ego, etc. Regardless of whether such doctrines may or may not apply, those doctrines must be asserted in a proceeding to which the entity sought to be bound is made a party and entitled to resist. That is the essential element lacking in this case.

To address this issue, the Fifth Circuit Court of Appeals discussed the relationship between the parties (discussed earlier as incorrect and begging the question of the fact that the noteholders did not have the opportunity to rebut). The court held that because there were obviously relationships between and among the noteholders and DDI, that the noteholders being bound by the decision to which they were not allowed an opportunity to resist "would be fair and appropriate." The Fifth Circuit also states that DDI had notice of the potential determination. Not only is all of this vehemently disputed but, if true, this was irrelevant. DDI had no standing to attempt to collect the note, to litigate over legal liability over the note or to represent the noteholders. The promissory note was not payable to DDI, DDI was not a limited partner of Montgomery 666, Ltd., DDI is not the

same as Drago Daic, Trustee, DDI is not liable on the note, as an assignee of the note, or an owner of the note and has no standing to collect the note even had it desired and sought to do so. Adequate notice to DDI (which is denied) is no notice at all to the noteholders. The fact that an individual by the name of Drago Daic has an interest in any number of the entities is no grounds to bind independent entities with different legal rights and liabilities to the blanket outcome of an arbitration and court proceeding to which some of such entities were not parties. Many of these principles were pointed out in the dissent of the only one of the three arbitrators who had experience as a sitting judge of a court (attached to the award – *see* Appendix F).

II. THE COURT ERRED IN HOLDING THAT ISSUES RELATING TO LEGAL LIABILITY ON THE PROMISSORY NOTE WERE SUBMITTED TO ARBITRATION.

Without the noteholders' presence as indispensable parties (payees on a note are indispensable parties to the issue of the payor's legal liability to the payee on the note) it should be legally impossible to decide the issue of legal liability on the promissory note in a way to bind the noteholders. Additionally, it can only but be again stated that there are no pleadings, and was virtually no evidence, submitted in arbitration relating to Nauru's legal liability on the promissory note. Neither DDI nor Nauru pled for collection of or relief from liability on the note in any pleadings, responses, counterclaims, closing motions or briefs. The only relief sought by Nauru relating to the note was indemnity from DDI for anything that Nauru

might have to pay on the note (which was denied – Award, page 3, paragraph V). Being parties to the proceeding, Nauru might seek indemnity from DDI for something Nauru might have to pay (indemnity in another lawsuit was granted in the same paragraph of the award). Recognizing the inherent difficulty in attempting to prove a negative, it can only be said that pleading for relief from liability on the promissory note and evidence that the noteholders' case against Nauru (which was being litigated in State District Court in Montgomery County) was not valid is simply not in the arbitration record. Subject matter jurisdiction is as essential as in personam jurisdiction in order for a valid determination to be rendered. *U.S. Rubber Co. v. Poage*, 297 F.2d 670 (C.A. Tex. 1962). These principles also support the lack of notice issue (*see* Section I, *supra*).

Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 115 S.Ct. 1212, 131 L.Ed.2d 76 (1995) held that parties may specify rules of contract under which they may arbitrate since arbitration is a creature of contract. The contracts do not provide that the noteholders agree to submit to any arbitration (and certainly no arbitration to which they were not a party). The contracts provide that they will be governed by Texas law. The contracts (and both Federal and Texas law) require notice and an opportunity to be heard. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 1920, 115 S.Ct. 1920 (1995) holds that, on the issue of an arbitrability of a specific issue (the question presented in this instance), there should be clear and unmistakable evidence. Under a clear and unmistakable evidence standard, the pleadings and evidence in this cause fall woefully short of any agreement to arbitrate or

actually litigating the issue of legal liability on the promissory note (a not surprising state of affairs in view of the fact that the noteholders did not have an opportunity to present their case). Indeed, Nauru's representative testified in the arbitration proceeding that he was aware that issues related to the promissory note were subject to the determination by the State Court in Montgomery County.

Despite the federal policy favoring arbitration, it is suggested that arbitration goes too far when the results of a decision are applied to an entity who did not agree to arbitrate and was not joined in the proceeding. If the powers of arbitrators are expanded beyond rational limits, it is further suggested that utilization of arbitration will decrease since neither parties nor their attorneys would be inclined to agree to a procedure so unpredictable.

III. THE DECISION EXHIBITS MANIFEST DISREGARD OF THE LAW WHICH SHOULD BE GROUNDS FOR OVERTURNING AN ARBITRATION AWARD.

The decision of the arbitration panel and the courts below purport to impose a significant legal detriment (cancellation of an $8,000,000.00 obligation) on entities not parties to the arbitration below or the district court proceeding or this appeal, who were not given notice that their rights might be affected, who were not allowed an opportunity to participate in any proceeding, based upon a ruling against such entities on an issue that was not subject to, and was not submitted in, arbitration. A decision on legal liability on a promissory note to a third

party should not be litigated so as to bind such third party in a proceeding to which such third party is not a part. In personom jurisdiction was lacking. Subject matter jurisdiction was lacking. Arbitrators exceeded their powers and ruled on a matter not submitted. The ruling itself was that Nauru had no legal liability on the promissory note because the developer (DDI) had materially breached the contract and was terminated with cause. The agreement itself specifically and clearly provides that the termination of DDI with cause does not affect the obligation to pay, or the rights of the noteholders under, the promissory note. Regardless of whether DDI performed or otherwise, the noteholders (who have not been paid for the land they sold to Nauru) are still entitled to sums if the project ever has cash flow with a new developer, or Nauru sells the project in bulk, or if Nauru develops the project and the project sustains positive cash flow. There could hardly be a better example manifest disregard of the law.

This court has approved the concept in principle. *First Options of Chicago Inc., supra; Wilko v. Swan,* 346 U.S. 427 (1953). Another court has approved the concept as well. *Conn. Tch. Dev. Co. v. University of Connecticut, Educ. Props., Inc.,* 102 F.3rd 677 (2nd Cir. 1996). This court should firmly establish the principle. Manifest disregard of the law would warrant voiding the arbitrators' award and the decisions of the courts below as to the noteholders in any respect.

CONCLUSION

The Court of Appeals for the Fifth Circuit purported to adversely decide the rights of entities not parties to the proceeding and over which it had no jurisdiction, on a question not properly before any arbitration panel or any court (in the absence of joinder of such parties) and further purported to reach out and bind those parties by the results of such decision without such parties being joined in the instant proceeding with notice and an opportunity for a hearing. The basis of the holding against the noteholders was directly contradictory to the terms of the contract itself. This is fundamentally wrong. It is requested that this Honorable Court grant the Petition for Writ of Certiorari and reverse that portion of the decision of the United States Court of Appeals.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 97-20279

NAURU PHOSPHATE ROYALTIES, INCORPORATED, (Texas),

Plaintiff-Appellee

versus

DRAGO DAIC INTERESTS, INCORPORATED,

Defendant-Appellant

Appeal from the United States District Court
for the Southern District of Texas

March 31, 1998

Before HIGGINBOTHAM and STEWART, Circuit Judges, and WALTER[1], District Judge.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Drago Daic Interests, Inc. appeals a district court order confirming the award granted to Nauru Phosphate Royalties (Texas), Inc. in an arbitration proceeding. The arbitration panel determined that DDI materially breached the Development Agreement between Nauru and DDI and held the beneficiaries of the agreement, Drago Daic, Trustee, and Montgomery-666, bound by its award. This case asks us to determine whether Nauru's

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[1] District Judge of the Western District of Louisiana, sitting by designation.

liability on the Promissory Note was properly before the arbitration panel. We hold that the arbitration panel did not exceed its authority in ruling on Nauru's liability on the Promissory Note and AFFIRM the district court's judgment. We reject any suggestion that because Daic Trustee and M-666 were not parties to the arbitration or to this case, the breach of the Development Agreement and Nauru's consequent non-liability on the Promissory Note were beyond the reach of the arbitration. Finally, the district court did not err in concluding that DDI was responsible for Nauru's loss of reimbursement funds for 122 lots and for cost overruns incurred in excavating a drainage ditch.

I.

In 1990, Nauru Phosphate Royalties, Inc., a Delaware corporation, entered into a sale and development agreement with three parties – (i) Drago Daic Interests, Inc., (ii) Drago Daic, Trustee, and (iii) Montgomery 666, Ltd. Nauru purchased 668 acres in Montgomery County, Texas, from Daic Trustee and M-666 for $5 million in cash and an $8 million Promissory Note. The Promissory Note was secured by a Deed of Trust lien on the land being sold. Nauru agreed to retain DDI, as developer, to develop the land into an up-scale residential housing subdivision, called Bentwood, with a country club, golf course and the like.

The Development Agreement and Promissory Note, when read together, set up the following arrangement: Nauru was to fund all monies necessary for the development project and be reimbursed for all of its expenditures

in a given calendar year from that year's revenue. If expenditures exceeded revenues, no payments would be made other than to Nauru. Only if revenues exceeded expenditures would payment be made on the Promissory Note. This was to continue until the Promissory Note was fully paid or the project sold, whichever came first. Stated directly, in the event that revenues did not exceed expenditures, the noteholders, Daic Trustee and M-666, would not be entitled to payment on the Promissory Note.

The project began in 1990 and continued into 1995. The property never achieved enough cash flow to pay current expenses, much less reimburse Nauru or make any payments on the Promissory Note. DDI was dissatisfied with Nauru's timeliness of funding, Nauru was unhappy about the costs and expenses, and the noteholders, Daic Trustee and M-666, were unhappy about not being paid. Eventually, Nauru gave notice of intent to terminate DDI as developer and instituted an arbitration proceeding.

In the arbitration, Nauru claimed DDI fraudulently induced Nauru to enter into the transaction and to continue development with various cost overruns. In addition, Nauru claimed that DDI materially breached the Development Agreement and sought indemnification from DDI for any liability on the contingent, nonrecourse Promissory Note to Daic Trustee and M-666. DDI counterclaimed that Nauru's actions caused the project to fail. DDI also sought to recover "profits" which assertedly were due.

In 1996, the arbitration panel (2-1) determined that DDI had committed thirteen material breaches of the

Development Agreement between the parties, and Nauru had committed three non-material breaches of the Development Agreement. The panel responded to Nauru's claim for indemnification of any liability on the Promissory Note by deciding that Nauru had no further liabilities to DDI under the Development Agreement and that Nauru had no liability for payment of the $8 million Promissory Note. This Note was executed by Nauru and payable to the noteholders, Drago Daic, Trustee and Montgomery-666, who were not parties to the arbitration proceeding. Finally, the panel decided that DDI was liable to Nauru for over $1.8 million as a result of DDI's material breaches of the Development Agreement.

Nauru then filed an action in district court to confirm the arbitration award. DDI moved to dismiss for lack of jurisdiction and also moved to vacate or modify the award. The district court denied the motion to dismiss and referred the matter to a magistrate judge, who recommended that the award be confirmed. In 1997, the district court accepted the magistrate judge's findings and recommendations and confirmed the arbitration award. This appeal followed.

II.

We must first determine if there is federal jurisdiction. DDI contends that the district court erred in sustaining federal jurisdiction on the basis of diversity of citizenship[2].

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[2] It is well-established that the Federal Arbitration Act does not create federal jurisdiction. Some independent jurisdictional

DDI is a Texas corporation with its principal place of business in Texas and Nauru is a Delaware corporation. Complete diversity turns here on the location of Nauru's principal place of business. Nauru argues that its principal place of business is in Australia or Nauru, a small island republic in the south Pacific. DDI argues Nauru's principal place of business is in Texas.

This court applies a "total activity" test to determine the principal place of business. *J.A. Olson Co. v. City of Winona, Miss.*, 818 F.2d 401, 411-12 (5th Cir. 1987). We look to the nature, location, importance, and purpose of a corporation's activities and the degree to which those activities bring the corporation into contact with the local community. *Id.* Three general principles drawn from the insights of Professor Wright guide the inquiry (*see* Wright, *Federal Courts* § 27, at 167-68 (5th ed. 1994)):

> (1) when considering a corporation whose operations are far flung, the sole nerve center of that corporation is more significant in determining principal place of business; (2) when a corporation has its sole operation in one state and executive offices in another, the place of activity is regarded as more significant; but (3) when the activity of a corporation is passive and the "brain" of the corporation is in another state, the situs of the corporation's brain is given greater significance.

Olson, 818 F.2d at 411 (citations omitted).

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basis, either diversity or federal question, must be shown. *See, e.g., Baltin v. Alaron Trading Corp.*, 128 F.3d 1466, 1469 (11th Cir. 1997).

DDI asserts that the second *Olson* principle is applicable and locates Nauru's principal place of business in Texas because, even if its offices are in Nauru, its sole operations are in Texas. Nauru contends the third *Olson* principle is applicable and establishes its principal place of business in Nauru or Australia because its investment in Bentwood is passive and the bulk of the corporation's activities involve managing its affairs from its nerve center in Nauru or Australia. Thus, the critical inquiry involves the nature and quality of Nauru's activities with regard to Bentwood.

The district court determined that at the time this action was filed Nauru was a passive investor in land and its primary activities were management-oriented. This determination is supported by the record which indicates that Nauru's nerve center or "brain" is in Nauru or Australia, not in Texas. Bentwood is the only investment asset of Nauru, which was formed for the sole purpose of acquiring this asset. Nauru had four members on its board of directors, each of whom is a citizen of and resides in Nauru. Nauru has three officers – a president, a treasurer/ secretary and an assistant secretary. The president resides in Nauru, the treasurer/secretary resides in Australia, and the assistant secretary resides in Houston, Texas. Nauru maintains its offices and staff in Nauru and Australia. The assistant secretary functioned as a conduit of information to the directors and other officers in Australia and Nauru, and the Nauru Board and its officers made substantive and managerial-level decisions.

The single exception to the lack of significant operations at Bentwood is the Bentwood Country Club which

includes the golf course and restaurant/bar and generates a significant amount of gross revenue. The country club is operated by two wholly-owned subsidiaries of Nauru – the Bentwood Country Club, Inc. and Bentwood Private Club, Inc.

Other circuits have held that the operations of a subsidiary are not to be imputed to a parent company for purposes of locating the parent's principal place of business, at least so long as the subsidiary is not the *alter ego* of the parent. *Taber Partners, I v. Merit Builders, Inc.*, 987 F.2d 57, 61-63 (1st Cir.) *cert. denied*, 510 U.S. 823 (1993); *Danjaq, S.A. v. Pathe Comm. Corp.*, 979 F.2d 772, 774-76 (9th Cir. 1992); *Pyramid Sec. Ltd. v. IB Resolution, Inc.*, 924 F.2d 1114, 1120 (D.C. Cir.), *cert. denied*, 502 U.S. 822 (1991). This court has attributed a subsidiary's citizenship to its parent company in *alter ego* situations where the subsidiary's wrongful conduct is at issue. *Kuehne & Nagel (AG & Co.) v. Geosource, Inc.*, 874 F.2d 283, 290-91 (5th Cir. 1989). There is no evidence that the corporate form of Nauru's subsidiaries should be disregarded and the subsidiaries treated as *alter egos* of Nauru.

The district's court determination that Nauru's principal place of business is not in Texas is amply supported by the record and hence is not clearly erroneous.

III.

A court "may not reconsider an award based on alleged errors of fact or law or misinterpretation of the contract." *Exxon Corp. v. Baton Rouge Oil & Chemical Workers Union*, 77 F.3d 850, 853 (5th Cir. 1996) (citing *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29,

36 (1987)); *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1320 (5th Cir. 1994) ("We must sustain an arbitration award even if we disagree with the arbitrator's interpretation of the underlying contract as along [sic] as the arbitrator's decision 'draws its essence' from the contract.") (citations omitted). As long as an arbitration award "is rationally inferable from the letter or purpose of the underlying agreement," the award should be upheld regardless of alleged errors of law or fact. *Executone*, 26 F.3d at 1320.

A.

DDI contends that the arbitration panel's decision regarding Nauru's liability on the Promissory Note was not enforceable since the panel exceeded its authority. DDI urges that Daic Trustee and M-666 signed the Development Agreement only with respect to Section 3.7 and Article 5, and the applicability of the Development Agreement to them is limited to these provisions. Relatedly, DDI contends that Daic Trustee and M-666 were not parties to the arbitration, and the issue of Nauru's liability on the Promissory Note could not be decided in their absence.

Their arguments are not persuasive. At the outset, the provisions of both the Development Agreement and the Promissory Note reveal that the two documents are inextricably intertwined. The first paragraph in the Promissory Note states in relevant part:

> The terms of the Earnest Money Contract and the Development Agreement are hereby incorporated into this Note as if fully set forth in this Note.
>
> Not only does it fully incorporate by reference the Development Agreement, the Promissory Note is explicitly referenced throughout the Development Agreement.

The arbitration clause in the Development Agreement provides:

> Any dispute, controversy or claim arising out of or in connection with or relating to this Agreement or any breach or alleged breach hereof, shall, upon the request of any party involved, be submitted to and settled by arbitration in Houston, Texas pursuant to the rules then in effect of the American Arbitration Association.

As this court has noted, "[w]hen parties include such a broad arbitration clause, they intend the clause to reach all aspects of the relationship." *Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210, 213 n. 2 (5th Cir.), *cert. denied*, 509 U.S. 923, 113 S.Ct. 3039, 125 L.Ed.2d 725 (1993). Here, Nauru's demand for arbitration states that DDI's failure to perform pursuant to the Development Agreement affects its liability on the Promissory Note. Thus, DDI knew that Nauru's liability on the Promissory Note was indeed an issue before the arbitration panel.

Further, by virtue of the two agreements, the Development Agreement had to be performed without material breach by DDI in order for the noteholders to be paid. Nauru's duty to make payment pursuant to the Promissory Note was a "conditional obligation," and Nauru

had "certain set-off rights" against its obligation to pay which were specified in the Development Agreement. By the very terms of the Promissory Note, any material breach of the Development Agreement by DDI would put payment on this Note at risk. The evidence on record shows that Mr. Drago Daic wanted DDI to be the developer of Bentwood pursuant to the Development Agreement to ensure that the Promissory Note would be paid. Thus, the Development Agreement and the Promissory Note were intimately related to one another, and the district court did not err in finding that the arbitration panel had the authority to rule on Nauru's liability on the Promissory Note since it was intimately "related to" the Development Agreement. Indeed, it goes to the heart of the dispute over DDI's performance of the Development Agreement.

The contention that the arbitration panel exceeded its authority in finding no liability on the Promissory Note because Daic Trustee and M-666 are not bound by the panel's findings fails in its premise. As effective third-party beneficiaries, the noteholders may be precluded from litigating the issue of breach of the Development Agreement in any subsequent proceeding and may be bound by the panel's finding of non-liability on Nauru's part for the Promissory Note. *Guscott et al. v. City of Boston*, 958 F.2d 361, 1992 WL 55889, at *3 (1st Cir. Mar. 25, 1992) (noting that third-party beneficiary lacked right to enforce a contract for its own benefit when contracting party breached a contractual condition that had to be satisfied for third-party beneficiary to receive payment); Restatement (Second) of Judgments § 56, cmt. a ("When a judgment is entered in an action between the promisee

and the promisor that terminates the obligation so far as the promisee is concerned . . . , it . . . discharges the obligation in favor of the beneficiary."); 18 Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction* § 4460, at 530 (1981) ("Substantive rules governing the rights of third-party beneficiaries . . . shape preclusion rules. So long as the promisee retains the power to discharge the obligation of the promisor, the third-party beneficiary is precluded by litigation between the promisee and promisor."); Restatement (Second) of Contracts § 309(2) & § 309(2) cmt. b ("If a contract ceases to be binding in whole or in part because of . . . present . . . failure of performance, the right of any beneficiary is to that extent discharged or modified." "Where there is a contract, the right of a beneficiary is subject to any limitations imposed by the terms of the contract.").

Our decision to hold that the arbitration award effectively decides any "right" of Daic Trustee and M-666 to be paid under the Promissory Note is also supported by the district court's findings. The district court noted that DDI, which did participate in the arbitration, had the same interests at stake as Daic Trustee and M-666. The record in this case demonstrates that the man behind all three entities – Daic Interests, Daic Trustee and M-666, – Mr. Drago Daic[3], fully participated in the arbitration

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[3] The evidence on record establishes the following:

Mr. Drago Daic is the sole owner of DDI.

Mr. Drago Daic, as Trustee, represents the 3-D Trust, a verbal trust established by Mr. Drago Daic for his children and grandchildren.

proceedings. The district court concluded that the two noteholders had notice that liability on the Promissory Note would be resolved by the arbitration panel since Nauru in its arbitration complaint contested the demands made by Daic Trustee and M-666 for payment pursuant to the Promissory Note. Thus, the record establishes that there was sufficient identity of interests among the three entities, DDI, Daic Trustee and M-666, that it would be fair and appropriate to hold the noteholders bound by the panel's finding of non-liability on the Promissory Note.

It bears mention that an arbitration award may be enforced in a subsequent proceeding against parties that did not participate in an arbitration in circumstances when the parties to the arbitration had related and congruent interests which were properly advanced during the arbitration. *See, e.g., Isidor Paiewonsky Assocs., Inc. v. Sharp Properties, Inc.*, 998 F.2d 145, 155 (3d Cir. 1993) (holding non-parties to arbitration clause since they have "related and congruent interests" with the principals);

Fifty-five percent of M-666 is effectively controlled by Mr. Drago Daic. Another company owned and controlled by Mr. Drago Daic, Imperial Marketing, owns another 19.33% of M-666.

Mr. Drago Daic, individually, or in his capacity as Trustee, owns a 75% interest in the Promissory Note.

The land which was sold to Nauru for the Bentwood development was initially purchased by Mr. Drago Daic in 1983 for approximately $3.8 million. Within 30 days of purchasing the land, Mr. Drago Daic sold the land at a substantial profit in equal 50% shares to Drago Daic, Trustee and M-666. Drago Daic, Trustee and M-666 entered into a joint venture agreement with respect to the land, with Mr. Drago Daic acting as managing joint venturer.

Cecil's, Inc. v. Morris Mechanical Enters., Inc., 735 F.2d 437, 439-40 (11th Cir. 1984) (enforcing indemnification agreement between general contractor and subcontractor even though underlying liability was determined by arbitration to which subcontractor was not a party); *In re Oil Spill by the "Amoco Cadiz"*, 659 F.2d 789, 795-96 (7th Cir. 1981) (binding plaintiff to outcome of arbitration between its principal and defendant even though plaintiff would be non-party to arbitration proceedings).

We are cautious in concluding that an arbitration panel can effectively determine the "rights" of the noteholders when they were not formal parties to the arbitration. *See First Options, Inc. v. Kaplan*, 115 S.Ct. 1920, 1924 (1995) (noting that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clear and unmistakable' evidence that they did so") (citations omitted). As a general matter, the interests of judicial economy ought not to be furthered by drawing non-parties within the gravitational force of an arbitration by shortchanging their legitimate wish to pursue their claims in court. That is not the case here. The non-parties to the arbitration, Daic Trustee and M-666, were third-party beneficiaries of the contract between the parties in arbitration with an interest contingent upon faithful performance of the contract by DDI. When DDI breached the Development Agreement, the noteholders' interests were necessarily at risk. The interests of DDI, Daic Trustee and M-666 were identical and adequately represented by a party in arbitration, DDI, and Daic Trustee and M-666 undoubtedly attempted to enforce the Development Agreement against Nauru. The heart of the matter is that the value of the Promissory Note depended entirely upon

performance by others over whom the noteholders had no legal control – not in the sense that their asset was determinable by external market forces – but by the very terms of the Promissory Note they held. In these circumstances, the district court did not err in finding a failure of a condition for liability upon the Promissory Note, a decision that forecloses Daic Trustee and M-666.

Finally, that the arbitration award effectively binds Daic Trustee and M-666 preventing them from relitigating the breach of the Development Agreement works no injustice. While Daic Trustee and M-666 were not formal parties to the arbitration, they were parties to the agreement to arbitrate. Since the Promissory Note incorporated the Development Agreement by reference, the sweeping arbitration clause in the Development Agreement bound both Daic Trustee and M-666. *Heinhuis v. Venture Assoc., Inc.*, 959 F.2d 551, 553-54 (5th Cir. 1992) (holding that parties to an excess insurance policy, which incorporated by reference the underlying insurance policy, were bound by the arbitration clause contained in the underlying insurance policy). Indeed, in a letter dated February 9, 1995, Daic Trustee and M-666 attempted to enforce sections of the Development Agreement, other than Sections 3.7 and 5, against Nauru. An entity's attempt to enforce an agreement that contains an arbitration clause provides clear and unmistakable evidence that the entity regards itself bound by the arbitration clause. *See Hughes Masonry Co. v. Greater Clark County Sch. Bldg. Corp.*, 659 F.2d 836, 839 (7th Cir. 1981); *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753, 757-58 (11th Cir. 1993), *cert. denied*, 513 U.S. 869 (1994); *J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, 319-21 (4th Cir. 1988);

McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co., 741 F.2d 342, 344 (11th Cir. 1984); *Sam Reisfeld & Son Import Co. v. S.A. Eteco*, 530 F.2d 679, 681 (5th Cir. 1976).

B.

The arbitration panel concluded that DDI was responsible for Nauru's loss of reimbursement funds for 122 lots located in the Porter Municipal Utility District, which was calculated by the panel to be $477,000.

DDI contends that the Development Agreement did not allow for loss of reimbursement funds, but rather provided for an offset against other amounts due under the Development Agreement and Promissory Note. The Development Agreement provided with respect to this expected MUD reimbursement expense:

> It is anticipated that certain drainage, wastewater treatment, water purification and other utility facilities (the "Utility Improvement") will be required to be constructed on the Property in connection with the Project. Developer expects that the Municipal Utility District ("M.U.D.") to be formed to operate such Utility Improvements will purchase the Utility Improvements at a price equal to seventy percent (70%) of the cost incurred in constructing such Utility Improvements.

The arbitration record shows that some of the development property was located in an existing MUD, the Porter MUD, while the rest of the property was in a MUD created specifically for the development, the Bentwater MUD.

DDI argues that the arbitration panel did not apply the proper contractual remedy and miscalculated the amount of the award. We are not persuaded. The arbitration panel's implicit assumption that this Section, which allowed for offsets of reimbursement losses, did not apply to reimbursement losses associated with an existing MUD, the Porter MUD, but rather was directed at a MUD to be formed in the future, is an interpretation of this Section that the arbitration panel was allowed to make. *See Executone*, 26 F.3d at 1320.

The arbitration panel also concluded that DDI was responsible for cost overruns incurred in excavating a large drainage ditch. DDI contends that the arbitration panel's decision that it should reimburse Nauru for cost overruns on the drainage ditch is contrary to principles of waiver under Texas law. DDI argues that Nauru waived any right to complain about cost overruns since it failed to object to a management decision made by DDI regarding the excavation.

There is no evidence from the award itself that the arbitration panel ignored Texas law on waiver. On the contrary, the panel might reasonably have attributed the cost overruns to DDI, which was found to have mismanaged the development project in several material respects, and, under Section 6.1(c) of the Development Agreement, DDI could be held responsible for these cost overruns. The district court correctly confirmed the arbitration award regarding the Porter MUD and the drainage ditch.

IV.

We hold that the district court had jurisdiction and did not err in confirming the arbitration award.

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

NAURU PHOSPHATE ROYALTIES,	§	
Plaintiff,	§	
VS.	§	CIVIL ACTION NO. H-96-0554
DRAGO DAIC INTERESTS, INC.,	§	
Defendant.	§	

FINAL JUDGMENT

(Entered Mar. 20, 1997)

For the reasons set forth in this Court's separate Order Adopting Recommendation of the Magistrate Judge, signed this day, and the Memorandum and Recommendation of the Magistrate Judge signed February 3, 1997, which Memorandum is adopted in its entirety as the opinion of this Court, it is

ORDERED and ADJUDGED that Defendant's Motion to Modify Arbitration Award or to Vacate Arbitration Award (Document No. 10) is DENIED, and that Plaintiff's Motion to Confirm Arbitration Award in Support of Final Judgment (Document No. 1) is GRANTED. It is further

ORDERED and ADJUDGED that the Arbitration Award dated February 9, 1996, attached hereto as Exhibit "A," is CONFIRMED as the judgment of this Court.

This is a FINAL JUDGMENT.

The Clerk will enter this Order and send copies to all parties of record.

SIGNED at Houston, Texas, this 18th day of March, 1997.

/s/ Ewing Werlein, Jr.
EWING WERLEIN, JR.
UNITED STATES DISTRICT JUDGE

EXHIBIT A

AMERICAN ARBITRATION ASSOCIATION
CAUSE NO. 70 199 0033 95K

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.	BEFORE A PANEL OF ARBITRATORS HOUSTON, TEXAS
VS.	PURSUANT TO THE RULES OF THE AMERICAN ARBITRATION ASSOCIATION
DRAGO DAIC INTERESTS, INC.	

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AWARD OF ARBITRATORS

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The arbitration panel of Judge Ross Sears (party arbitrator appointed by Drago Daic Interest, Inc.), Charles J. Jacobus, Sr. (party aribtrator appointed by Nauru Phosphate Royalties (Texas), Inc.) and Patrick T. Sharkey (designated neutral arbitrator), collectively called the "Arbitrators", have considered the pleadings, evidence, arguments, and documentary exhibits and have made the following conclusions and awards:

I. FRAUD IN INDUCEMENT TO PURCHASE PROPERTY

The Arbitrators find no fraud in the inducement. The arbitrators find that Nauru Phosphate Royalties (Texas), Inc. ("NPR") relied on the advice of its own advisor, Ken Walker, in making the acquisition of the subject property.

II. FRAUD IN INDUCEMENT TO DEVELOP THE LAND

The Arbitrators find no fraud on DDI's part in inducing NPR to continue with the development of Bentwood. NPR chose to ignore the advice of its local representatives, Kirk Breitenwischer and Charles Ackerman and elected to proceed with the development of Bentwood.

III. BREACH OF CONTRACT

The Arbitrators have considered each of allegations regarding breaches of contract raised by both parties and have found the following breaches of contract to have occurred:

A. Breaches of Contract by DDI

1. Sec. 3.1(b) failure to provide on-site management,
2. Sec. 3.1(c) failure to provide three candidates for project engineer,
3. Sec. 3.1(d) failure to provide three candidates for project architect,
4. Sec. 3.1(e) failure to competitively bid each contract and failure to properly select contractors,
5. Sec. 3.1(g) failure to properly supervise the project,
6. Sec. 3.1(h) failure to verify the accuracy of draw requests,
7. Sec. 3.1(k) failure to prepare and submit marketing plan,

8. Sec. 3.2 failure to exercise good faith standard of performance,

9. Sec. 3.6(b) by allowing liens on the property,

10. Sec. 3.7 filing a lis pendens on the property and failing to provide the required releases on Lot 15,

11. Sec. 6.1(b) failing to adhere to its approved operating budget,

12. Sec. 6.1(c) failure to submit changes of operating budgets,

13. Sec. 8.1(b) failure to return NPR's books and records.

B. Breaches of Contract by NPR

1. Sec. 6.1(B) failure to fund timely,

2. Sec. 4.5 failure to timely provide job description for NPR's local representative,

3. Sec. 7.1(a) failure to pay initial funds of $400,000 within 20 days of the date of the Development Agreement.

Notwithstanding the Arbitrator's findings of breaches of the Development Agreement by NPR, the Arbitrators determined the NPR's breaches were not material and resulted in no damages to DDI. On the other hand, the Arbitrators concluded that DDI's breaches of the Development Agreement were material and resulted in damages to NPR as further set out in this Arbitration Award.

IV. DECLARATORY JUDGMENT REGARDING TERMINATION OF DEVELOPMENT AGREEMENT

The Arbitrators find that NPR's termination of the Development Agreement as of March 31, 1995 was with cause. Consequently, the Arbitrators find that (i) the Development Agreement was properly terminated, (ii) NPR has no further duties to DDI under the terms of the Development Agreement, and (iii) NPR has no liability for payment of the eight million dollar promissory note executed by NPR and payable to Drago Daic, Trustee and Montgomery 666, LTD.

V. INDEMNIFICATION

The Arbitrators find that NPR is entitled to indemnification by DDI for all costs, including attorney's fees and court costs incurred by NPR in connection with the *Williford, et al. v. Drago Daic, Individually and as Trustee, et al.*, Cause No, 93-03-00876-CV in the District Court of Montgomery County, Texas, 221st Judicial District lawsuit. Conversely, the Arbitrators find that NPR has no duty to indemnify DDI under Section 12 of the Development Agreement. The Arbitrators further find that the Developer's Interest under Section 11 of the Development Agreement is $0.00. The Arbitrators further find that no indemnification for either party is warranted under Sec.12 of the Development Agreement in connection with the *Drago Daic, Trustee and Montgomery 666 LTD. v. Nauru Phosphate Royalties (Texas), Inc. and Bentwood Country Club, Inc.*, Cause No. 95-03-00842-CV in the district court of Montgomery County, Texas, 2nd Ninth Judicial District.

VI. NEGLIGENT MISREPRESENTATION

The Arbitrators find no negligent misrepresentation by DDI. There is no evidence in the record that shows reliance.

VII. DAMAGES

In assessing damages to be awarded in this arbitration proceeding, the Arbitrators follow the format set fourth [sic] in NPR's Summary of Certain Damages Claimed by NPR as revised on Sep. 15, 1995. The damage awards of the Arbitrators to be paid to NPR by DDI are as follows:

A. Fraud in Inducement to Purchase Property

$0.00

B. Fraud in Inducement to Develop Bentwood

$0.00

C. Direct Damages

1. DRAINAGE DITCH

a. Payment to Star to Hire Gary Daic

$0.00

Reason: no evidence of damages resulting from the $35,000 payment.

b. Payments to LeCon

$597,151.00

Reason: DDI's management decision to place dirt at sewer treatment place site which resulted in cost overrun. Sec. 6.1

of the Development Agreement places financial responsibility for cost overrun on DDI.

c. Payments to Nasr

$150,950.00

Reason: DDI's management decision to place dirt at sewer treatment place site which resulted in cost overrun. Sec. 6.1 of the Development Agreement places financial responsibility for cost overrun on DDI.

d. Fraudulent Sale of Equipment to NPR from Northeast Equipment Co. (A Gary Diac Co.)

$44,692.00

Reason: Ditch contract required contractor to supply all equipment. Therefore, DDI's authorization for payment of these funds is inappropriate. However, NPR must return the pump in its possession to DDI upon NPR's receipt of damages from DDI.

e. Costs Due to Payoff of Liens by NPR(T)

$0.00

Reason: Liens should have been paid by NPR out of Gary Daic's retainage.

f. Drainage Ditch Rework to be Completed by NRP(T)

$0.00

Reason: settlement with Star saved $149,000. No proof that the cost of

reworking the ditch will exceed savings from the Star settlement.

2. CLUBHOUSE, HALFWAY HOUSES

a. Damages for Third Party Work to Complete Clubhouse

$33,742.46

Reason: $173,946.46 cost paid to third parties to substantially complete clubhouse was offset by $140,204.00 savings on the Nasr clubhouse construction contract

b. Additional Repairs to Clubhouse

$43,700.00.

Reasons: The $43,700.00 award is comprised of the following elements:

(1) windows and repainting $25,000.00;

(2) roof repair $5,000.00;

(3) sidewalk repair $12,000.00;

(4) air handling in cart storage area $1,700.00.

No damages are awarded for the remaining complaints for repairs.

c. Damages for Cost to Complete Halfway Houses in Excess of Contract Amount

$9,404.41

d. Damages for M&M Liens on Clubhouse

The Arbitrators give DDI 120 days from the date of this award to settle and

obtain executed and notarized releases for the following 4 liens outstanding against the clubhouse:

(1) Coburn Supply Co. $1,535.77;

(2) Joyces Plastering Co., Inc. $8,076.00;

(3) Liberty Mechanical Corp. $26,946.68;

(4) Casteel Auto, Fire Protection $3,090.70.

On or before 120 days from the date of this award, DDI shall provide NPR with either the original fully executed and notarized releases of lien for each of the referenced liens or a cash payment in a sufficient amount to fully pay off any lien not released within the 120 day period.

3. ENTRY MONUMENT

$0.00

Reason: $10,000 payment to Nasr was in settlement of all claims. $35,000 damages request was speculative and without adequate proof.

4. DAMAGES DUE TO DELAY OF POWER INSTALLATION

$0.00

Reason: Delay in power installation was not due solely to DDI's actions.

5. LOSS OF REIMBURSEMENT FROM 122 LOTS LOCATED IN PORTER MUD

   $477,000.00

   Reason: $492,000.00, minus $15,000.00 for annexation costs.

6. NPR'S BOOKS AND RECORDS

   $4,997.64 for copy costs and DDI is hereby ordered to return all NPR's books and records to NPR within seven (7) days after the receipt of this award.

7. WILLIFORD INDEMNITY

   $33,206.56 plus all future legal fees and costs incurred by NPR as established by the 221st Judicial District Court of Montgomery County, Texas.

8. ATTORNEY'S FEES

   a. NPR is awarded attorney's fees in the amount of $393,283.50.

   b. DDI is awarded no attorney's fees.

9. PUNITIVE DAMAGES

   $0.00

10. ARBITRATION COSTS

    $0.00

    Reason: Sec. 13 of the Development Agreement provides as follows: "the expenses of the arbitration shall be borne equally by the parties to the arbitration."

This Award of Arbitrators is in full settlement and resolution of all claims and counterclaims submitted in this arbitration proceeding.

The date of this award is February 9, 1996.

/s/ Ross Sears/Dist
JUDGE ROSS SEARS

/s/ Charles J. Jacobus, Sr.
CHARLES J. JACOBUS, SR.

/s/ Patrick T. Sharkey
PATRICK T. SHARKEY

On this 9th day of February, 1996, before me personally came and appeared Judge Ross Sears, Charles J. Jacobus, Sr. and Patrick T. Sharkey, to me known and known to me to be the individuals described in and who executed the foregoing instrument, and they acknowledged to me that they executed the same.

/s/ Karen Smith
NOTARY PUBLIC,
STATE OF TEXAS

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

NAURU PHOSPHATE ROYALTIES, Plaintiff,	§	
VS.	§	CIVIL ACTION NO. H-96-0554
DRAGO DAIC INTERESTS, INC., Defendant.	§	

ORDER ADOPTING RECOMMENDATION OF THE MAGISTRATE JUDGE

(Entered Mar. 20, 1997)

Pending is Defendant's Motion to Modify Arbitration Award or to Vacate Arbitration Award (Document No. 10), and Plaintiff's Motion to Confirm Arbitration Award in Support of Final Judgment (Document No. 1). The Court has received from the Magistrate Judge a Memorandum and Recommendation recommending that Defendant's Motion to Modify Arbitration Award or to Vacate Arbitration Award (Document No. 10) be DENIED, and that Plaintiff's Motion to Confirm Arbitration Award in Support of Final Judgment (Document No. 1) be GRANTED. Defendant has filed timely objections to the Magistrate's Recommendation. After having made a *de novo* determination of Defendant's Motion to Modify Arbitration Award or to Vacate Arbitration Award, and Plaintiff's Motion to Confirm Arbitration Award in Support of Final Judgment this Court is of the opinion that the findings and recommendations of the Magistrate

Judge are correct and should be and hereby are accepted by the Court in their entirety. Accordingly,

It is ORDERED and ADJUDGED for the reasons set fourth in the Memorandum and Recommendation of the United States Magistrate Judge signed February 3, 1997, which is adopted in its entirety as the opinion of this Court, that Defendant's Motion to Modify Arbitration Award or to Vacate Arbitration Award (Document No. 10) is DENIED, and that Plaintiff's Motion to Confirm Arbitration Award in Support of Final Judgment (Document No. 1) is GRANTED.

The Clerk will enter this Order and send copies to all parties of record.

Signed at Houston, Texas, this 18th day of March 1997.

/s/ Ewing Werlein, Jr.
EWING WERLEIN, JR.
UNITED STATES
DISTRICT JUDGE

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

NAURU PHOSPHATES ROYALTIES, (TEXAS), INC.,	§	
Plaintiff,	§	
V.	§	CIVIL ACTION NO.
DRAGO DAIC INTERESTS, INC.,	§	H-96-0554
Defendant.	§	

MEMORANDUM AND RECOMMENDATION GRANTING MOTION TO CONFIRM ARBITRATION AWARD IN SUPPORT OF FINAL JUDGMENT AND DENYING MOTION TO MODIFY OR VACATE ARBITRATION AWARD

(Entered Feb. 04, 1997)

Before the Magistrate Judge is Plaintiff Nauru Phosphate Royalties (Texas), Inc.'s Motion to Confirm Arbitration Award in Support of Final Judgment (Document No. 1) and Defendant Drago Daic Interests, Inc.'s Motion to Modify or Vacate Arbitration Award (Document No. 10). On October 2, 1996, United States District Judge Ewing Werlein, Jr. referred the case to Magistrate Judge Frances H. Stacy pursuant to the Cost Delay and Reduction Plan instituted in the Southern District of Texas.

After reviewing the aforementioned motions, the responses and additional briefing, the findings of the arbitration panel in conjunction with the evidence presented at the arbitration, and the applicable law, the

Magistrate Judge RECOMMENDS, for the reasons set forth below, that Plaintiff's Motion to Confirm Arbitration Award be GRANTED and Defendant's Motion to Modify or Vacate Arbitration Award be DENIED.

I. Background

Sometime in 1990, Nauru Phosphate Royalties (Texas), Inc. ("Nauru") purchased land in Montgomery County from Drago Daic, Trustee ("Trustee") and Montgomery 666, Ltd. ("M-666"). In addition to the purchase of the land, Nauru entered into a development agreement ("Development Agreement") with Drago Daic Interests, Inc. ("DDI"), whereby DDI was to develop the land into a residential housing subdivision, which included a country club, golf course and other recreational facilities. In consideration for the land, Nauru paid five million dollars to Trustee and M-666. In addition, Nauru signed an eight million dollar promissory note (the "Promissory Note") payable to Trustee and M-666, which was to be paid when certain cash flow conditions set forth in the Development Agreement were met.

When problems arose with the development, Nauru terminated DDI as the developer of the project, and called for arbitration under the terms of the Development Agreement which Nauru and DDI had signed. Following 55 days of arbitration, the arbitrators found 2-1 in favor of Nauru. Essentially, the arbitrators found that DDI had breached the Development Agreement in several material respects, including:

(1) failure to provide on-site management

(2) failure to provide three candidates for project engineer

(3) failure to provide three candidates for project architect

(4) failure to competitively bid each contract and failure to properly select contractors

(5) failure to properly supervise the project

(6) failure to verify the accuracy of draw requests

(6) [sic] failure to prepare and submit marketing plan

(7) failure to exercise good faith standard of performance

(8) allowing liens to be placed on the property

(9) filing a lis pendens on the property and failing to provide a release for Lot 15

(10) failing to adhere to the approved operating budget

(11) failing to submit changes of operating budgets

(12) failing to return Nauru's books and records.

Although the arbitration panel also found that Nauru had breached the Development Agreement by failing to timely fund the project, failing to timely provide a job description for Nauru's local representative, and failing to pay initial funds of $400,000 within 20 days of the Development Agreement, the panel found that these breaches were not material and that such breaches resulted in no damages to DDI.

II. Nauru's Motion to Confirm Arbitration Award

In this proceeding, Nauru seeks an order of the Court which confirms the award of the arbitration panel in its entirety. Nauru also seeks a final judgment which will make the arbitration award binding and enforceable.

III. DDI's Motion to Modify or Vacate Arbitration Award

DDI seeks to vacate or modify the arbitration award on five grounds. First, DDI claims that the arbitration panel exceeded its authority and/or improperly exercised its authority when it determined that Nauru has no liability for payment of the eight million dollar Promissory Note executed by Nauru and payable to Trustee and M-666. According to DDI, Nauru's liability on the Promissory Note was not an issue which was submitted to the arbitration panel for a decision. Additionally DDI argues that because the parties to the Promissory Note, Trustee and M-666, were not parties to the arbitration, they should not be bound by a decision of the arbitration panel which substantially affects their rights. Second, DDI claims that the arbitration panel exceeded its authority when it ignored controlling Texas law and determined that DDI was liable for water and sewer facility reimbursement costs associated with the Porter Municipal Utility District ("Porter MUD"). DDI also claims that the arbitration panel, to the extent it did not exceed its authority in making an award to Nauru related to the Porter MUD issue, miscalculated the amount of damages associated with the Porter MUD issue. Third, DDI maintains that the

arbitration panel exceeded its authority when it determined, contrary to Texas law, that DDI was responsible for cost overruns on the drainage ditch which was excavated at the development site. Fourth, DDI maintains that the arbitration panel erred and exceeded its authority when it determined that DDI was responsible for cost overruns on the construction of the clubhouse, repairs needed on the clubhouse, and liens placed on the clubhouse. Fifth, DDI argues that in the event any of the foregoing issues are modified, the attorney's fees awarded to Nauru should be modified.

IV. Grounds upon which an Arbitration Award may be Vacated, Modified or Corrected

Under the Federal Arbitration Act, an arbitration award may only be modified under the following circumstances:

> (1) the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, or refusing to hear evidence pertinent and material to the controversy, or of any misbehavior by which the rights of any party had been prejudiced;
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made;

> (5) where an award was an evident miscalculation of figures or an evident material mistake in the description of any person, thing or property referred to in the award;
>
> (6) where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; and
>
> (7) where the award is imperfect in matter of form not affecting the merits of the controversy.

9 U.S.C. §§ 10, 11.

Under the Texas Arbitration Act, an arbitration award may only be modified under the following similar circumstances:

> (1) the award was procured by corruption, fraud or other undue means;
>
> (2) there was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct or wilful misbehavior of any of the arbitrators prejudicing the rights of any party;
>
> (3) the arbitrators exceeded their powers;
>
> (4) the arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 171.005, as to prejudice substantially the rights of a party;
>
> (5) there was no arbitration agreement and the issue was not adversely determined in proceedings under Section 171.002 and the party did not participate in the arbitration hearing without raising the objection;

> (6) there was an evident miscalculation of figures or an evident mistake in the description of any person, thing, or property referred to in the award;
>
> (7) the arbitrators have awarded upon a matter not submitted to them and the award may be corrected without affecting the merits of the decision upon the issues submitted; or
>
> (8) the award is imperfect in a matter of form, not affecting the merits of the controversy.

TEX. CIV. PRAC. & REM. CODE §§ 171.014, 171.015. Because the Court found, in connection with its ruling denying Defendant's Motion to Dismiss, that Nauru's principal place of business is in Nauru (Document No. 22), we apply the Federal Arbitration Act to this transaction which involved interstate commerce. *Atlantic Aviation, Inc. v. EBM Group, Inc.*, 11 F.3d 1276, 1280 (5th Cir. 1994) ("This Court has held that a contract may involve commerce under the [Federal Arbitration Act] if the parties engaged in the performance of contract activities are citizens of different states, where such a contract involves interstate travel of both personnel and payments").

In ruling on a motion to vacate an arbitration panel's award, the District court's function is limited. Whenever possible, great deference is given to the arbitrators' decision. *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, 918 F.2d 1215, 1218 (5th Cir. 1990), *cert. denied*, 501 U.S. 1206 (1991). If the arbitration award "draws its essence" from the agreement between the parties and the "arbitrator is not fashioning 'his own brand of industrial justice,' the award cannot be set aside." *Delta*

Queen Steamboat Co. v. District 2 Marine Engineers Beneficial Assoc., 889 F.2d 599, 602 (5th Cir. 1989), *cert. denied*, 498 U.S. 853 (1990). In other words, an arbitration award must be upheld by the District Court if the arbitrator's decision "is rationally inferable from the letter or purpose of the underlying agreement." *Executone Information Systems, Inc. v. Davis*, 26 F.3d 1314, 1320 (5th Cir. 1994); *See also Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210, 214 (5th Cir.), *cert. denied*, 509 U.S. 923 (1993); *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, 918 F.2d 1215, 1218 (5th Cir. 1990), *cert. denied*, 501 U.S. 1206 (1991). This is so even if the District Court disagrees with the arbitrators' resolution of the underlying facts or resolution of the legal issues, including the arbitrators' interpretation of the contract at issue. *United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29, 37-38 (1987); *see also Exxon Corp. v. Baton Rouge Oil*, 77 F.3d 850, 853 (5th Cir. 1996) ("We may not reconsider an award based on alleged errors of fact or law or misinterpretation of the contract"). "[A]s long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision." *United Paperworkers*, 484 U.S. at 38.

Despite the great deference which is to be given an arbitration award, such an award may be vacated if the arbitrator exceeded his authority under the arbitration agreement. *Delta Queen Steamboat Co. v. District 2 Marine Engineers Beneficial Assoc.*, 889 F.2d 599, 602 (5th Cir. 1989), *cert. denied*, 498 U.S. 853 (1990). The Fifth Circuit has consistently held that "federal courts are free to scrutinize the award to ensure that the arbitrator acted in

conformity with the jurisdictional prerequisites of the [agreement]. Where an arbitrator exceeds his contractual authority, a vacation or modification of the award is an appropriate remedy." *Id.* (citations omitted). In determining whether an arbitrator has exceeded his authority under the arbitration agreement, all doubts are resolved in favor of arbitration. *Dole Ocean Liner Express v. Georgia Vegetable Company*, 84 F.3d 772, 775 (5th Cir.), *opinion modified on other grounds*, 93 F.3d 166 (5th Cir. 1996); *Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210, 213 (5th Cir.), *cert. denied*, 509 U.S. 923 (1993); *National Union Fire Ins. Co. v. Belco Petroleum Co.*, 88 F.3d 129, 135 (2nd Cir. 1996); *Dighello v. Busconi*, 673 F.Supp. 85, 87 (D. Conn. 1987), *aff'd*, 849 F.2d 1467 (2nd Cir. 1988). Moreover, depending upon the breadth of the arbitration agreement, issues that are " 'inextricably tied up with the merits of the underlying dispute' may properly be decided by the arbitrator." *Dighello v. Busconi*, 673 F.Supp. at 87 (D. Conn. 1987) (quoting *McAllister Bros. v. A & S Trans. Co.*, 621 F.2d 519, 522-23 (2nd Cir. 1980)).

V. Issue 1: The Promissory Note

A. The Arbitration Panel's Finding

The Arbitration panel concluded with respect to the Promissory Note between Nauru and Trustee and M-666: "NPR [Nauru] has no liability for payment of the eight million dollar promissory note executed by NPR [Nauru] and payable to Drago Daic, Trustee and Montgomery 666 Ltd." Arbitration Award at page 3, attached to Nauru's Motion to Confirm Arbitration Award (Document No. 1)

as Exhibit "C". Nauru seeks to confirm this finding. DDI, on the other hand, seeks to vacate or modify this finding.

B. The Parties' Agruments

DDI argues with respect to the arbitration panel's decision on the Promissory Note that the arbitration panel exceeded its authority. First, DDI argues that Nauru's liability on the Promissory Note was not an issue the parties submitted to the arbitration panel. Second, DDI argues that because the arbitration clause pursuant to which the parties' dispute was arbitrated was contained in the Development Agreement, to which only Nauru and DDI were parties, the arbitration panel exceeded its authority when it determined that Nauru was not liable on the Promissory Note. For these reasons, DDI maintains that any determination made by the arbitration panel which affected the rights of Trustee and M-666 should be vacated or modified.

In response to DDI's arguments, Nauru argues that issues related to the Promissory Note were inextricably intertwined with issues related to the Development Agreement. Specifically, the Development Agreement set forth the conditions under which payments were required to be made on the Promissory Note. Under the terms of the Development Agreement, Nauru was obligated to make payments on the Promissory Note when certain cash flow conditions were met. Because issues arising from the Promissory Note were so interrelated with issues arising from the Development Agreement, Nauru contends that the arbitration panel did not exceed its authority in making a finding on Nauru's liability

under the Promissory Note. In addition, Nauru maintains that it supplied the arbitration panel with sufficient evidence that DDI, Trustee, and M-666 are all entities owned or controlled by Drago Daic, and therefore the arbitration agreement signed by Drago Daic on behalf of DDI should bind DDI, Trustee, and M-666.

C. The arbitration panel did not exceed its authority in making findings regarding the Promissory Note

Case law and the evidence in the arbitration record support Nauru's argument that the arbitration panel did not exceed its authority in making findings regarding the Promissory Note. The arbitration agreement, which is contained in the Development Agreement and which governed the parties' arbitration of their dispute, provides:

> *Any dispute, controversy or claim arising out of or in connection with or relating to this Agreement* or any breach or alleged breach hereof, shall, upon the request of *any party involved*, be submitted to and settled by arbitration in Houston, Texas pursuant to the rules then in effect of the American Arbitration Association. The party to this Agreement requesting arbitration shall submit written notice to the other party hereto of such request. Upon receipt of such notice, Owner and Developer shall within twenty (20) days each appoint an arbitrator and the two arbitrators so appointed shall within an additional fifteen (15) days appoint a third presiding arbitrator; provided, however, if the amount in dispute is less than Fifty Thousand

> Dollars ($50,000.00), the Owner and Developer may consent to arbitration by (and the terms of selection for) a single neutral arbitrator. Any award rendered shall be final and conclusive upon the parties and a judgment thereon may be entered in the appropriate court of the forum, state or federal, having jurisdiction. The expenses of the arbitration shall be borne equally by the parties to the arbitration. No arbitration shall be commenced after the date when institution of legal or equitable proceedings based upon such subject matter would be barred by the applicable statute of limitations. Notwithstanding anything to the contrary contained in this Section or elsewhere in this Agreement, (i) Owner shall not be precluded hereby from bringing an action for specific performance in the event of the failure by Sellers or Developer, as the case may be, to convey the Property to Owner or to deliver the Partial Release or Full Release described in Sections 3.7 and 5.4 hereof, and (ii) any party hereto may seek injunctive relief without first submitting the subject dispute to arbitration.

Section 13 – Dispute Resolution of Development Agreement, DDI Exhibits Vol. I, #15 at 63-64 (emphasis added).[1] Given the presumption in favor of arbitration, the broad provision for arbitration pursuant to which the parties agreed to arbitrate "[a]ny dispute, controversy or claim arising out of or in connection with or relating to" the

---

[1] The exhibits referred to herein are those submitted by the parties at the arbitration. DDI Exhibits refer to the exhibits submitted by DDI. Nauru Exhibits refers to the exhibits submitted by Nauru.

Development Agreement, and the fact that Nauru's liability on the Promissory Note is an issue that is undeniably "related to" the Development Agreement, the arbitration panel was authorized to resolve the issue of Nauru's liability on the Promissory Note. *See e.g. Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210, 213 (5th Cir.), *cert. denied*, 509 U.S. 923 (1993).[2]

The provisions of both the Development Agreement and the Promissory Note reveal the interrelatedness of the two agreements. The Promissory Note is referenced throughout the Development Agreement. Additionally, the Promissory Note fully incorporates by reference the terms and provisions of the Development Agreement. Implicit and explicit references are made to the Promissory Note throughout the Development Agreement. For example, on page 1 of the Development Agreement, the Promissory Note is implicitly and explicitly referred to in the parties' recitations:

> Nauru Phosphate Royalties (Texas), Inc. (the "Owner") and Drago Daic, Trustee and Montgomery 666, Ltd. (the "Sellers") have entered into an earnest money contract (the "Purchase Agreement") dated as of January ___, 1990, pursuant to which the Owner contracted to acquire

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[2] In *Valentine Sugars*, the Fifth Circuit Court of Appeals resolved the issue of whether an arbitration panel exceeded its authority when it ruled on an issue which was not presented to it. The Fifth Circuit, in relying on the broad wording of the arbitration agreement, which called for arbitration of "any dispute 'relating to or arising out of' the agreement", concluded that "[w]hen parties include such a broad arbitration clause, they intend the clause to reach all aspects of the relationship." *Valentine Sugars*, 981 F.2d at 213 n.2.

> from Sellers certain unimproved real property located in the County of Montgomery, State of Texas, known as 668 North Park, Houston, Texas and more particularly described in Exhibit "A" to the Purchase Agreement (the "Property").
>
> The Purchase Agreement contemplates that a Development Agreement for the Project be agreed between Owner and Drago Daic Interests, Inc. (the "Developer") and entered into at closing thereunder.

Development Agreement, DDI Exhibits Vol. 1, #15, page 1. On page 8 of the Development Agreement, Promissory Note is defined:

> The Promissory Note shall mean that certain promissory note made by Owner for the benefit of Sellers and further described in the Purchase Agreement.
>
> Development Agreement, DDI Exhibits Vol. 1, #15, page 8. On pages 27-30 of the Development Agreement, the obligations of Trustee and M-666, pursuant to the Purchase Agreement and Promissory Note, to execute partial releases upon the sale of residential lots in the development, are outlined:
>
> Developer acknowledges and agrees that each Lot is to be sold free and clear of all financing encumbrances, including the Deed of Trust executed by Owner for the benefit of Sellers and the Vendor's Lien and Superior Title retained by Sellers set forth in the conveying deed, all as further described in the Purchase Agreement. . . .

Development Agreement, DDI Exhibits Vol. 1, #15, pages 27-30. Additionally, and most significantly, on pages

34-40 of the Development Agreement, specific provisions are made for payments on the Promissory Note:

> Cash flow shall be calculated in accordance with generally accepted accounting principles, consistently applied, in accordance with the definition of "Cash Flow" contained herein, and distributed to Owner and Developer for each Year in the following order of priority:
> (a) First, subject to the provisions of Section 5.3, to Sellers in an amount equal to $1,600,000, as payment of principal due under the Promissory Note, until such Promissory Note has been paid in full;
> (b) Second, to Owner in an amount equal to the aggregate of all Project Expenses paid by Owner during the preceding Years *minus* the aggregate of all Cash Flow distributed to Owner during such preceding Years as reimbursement for such Project Expenses (such amount hereinafter referred to as "Unreiumbursed Project Expenses");
> (c) Third, to Sellers in an amount equal to the accrued, but unpaid principal due under the Promissory Note for prior Years. . . .

Development Agreement, DDI Exhibits Vol. 1, #15, pages 34-40. Likewise, the Promissory Note specifically references the Development Agreement. On page 1 of the Promissory Note, in the recitals section, the terms of both the Earnest Money Contract and the Development Agreement are fully incorporated into the Promissory Note:

> Nauru Phosphate Royalties (Texas), Inc., a Delaware corporation ("Maker"), and Drago Daic, Trustee, a Texas resident, and Montgomery 666 Ltd., a Texas limited partnership (collectively "Holder") have entered into that certain Earnest

> Money Contract dated January ___, 1990 (the "Earnest Money Contract") and have today closed that transaction set forth in the Earnest Money Contract. The Promissory Note (this "Note") is given to evidence the conditional obligation of Maker to pay payments of principal totaling up to $8,000,000.00 without interest thereon to Holder (the "Indebtedness"), subject to certain set-off rights of Maker, all as specified in the earnest Money Contract, by reference therein, Section 5 of the Development Agreement between Drago Daic Interests, Inc. and Maker dated as of January 22, 1990 (the "Development Agreement"). ***The terms of the Earnest Money Contract and the Development Agreement are hereby incorporated into this Note as if fully set forth in this Note.***

Promissory Note, DDI Exhibits Vol. 1, #5 at page 1 (emphasis added). And, on page 3 of the Promissory Note, certain remedies under the Promissory Note are conditioned upon DDI's full performance under the Development Agreement:

> In the case of an Event of Default under Section 4.1.1, Holder may, in its sole discretion and provided Drago Daic Interests, Inc. ("Developer") is not then in default under the Development Agreement, declare immediately due and payable the entire principal balance hereof, and Holder shall further be entitled to pursue any remedies available to it under the Deed of Trust.

Promissory Note, DDI Exhibits Vol. 1, #5 at page 3.

DDI does not and cannot maintain that the Development Agreement and the Promissory Note were distinct,

unrelated instruments. Given the references in the Development Agreement to the Promissory Note and the references in the Promissory Note to the Development Agreement, the Magistrate Judge concludes that the two instruments were inextricably intertwined. As such, issues arising under the Promissory Note were necessarily issues "related to" the Development Agreement. The arbitration panel, in deciding Nauru's liability on the Promissory Note resolved an issue "related to" the Development Agreement. Therefore, the arbitration panel did not exceed its authority when it decided Nauru's liability under the Promissory Note.

With respect to whether the issue of Nauru's liability on the Promissory Note was presented by the parties to the arbitration panel and whether the parties had notice that such an issue would be resolved by the arbitration panel, the Magistrate Judge concludes from the evidence in the arbitration record that such an issue was presented and that the parties had sufficient notice that the issue would be resolved.[3] First, there is evidence that Nauru, in

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[3] In *Valentine Sugars*, the Fifth Circuit addressed a notice claim similar to the one made by DDI herein, and concluded that there are no guidelines regarding the specificity of the notice to be afforded parties to an arbitration. In *Valentine Sugars*, the plaintiff argued that the arbitrators exceeded their authority by deciding the ownership of a spray dryer, an issue which was not specifically submitted to them. After concluding that the arbitration agreement was so broad as to encompass such an issue, the Fifth Circuit concluded that there are no notice rules which would preclude an arbitration panel from deciding such an issue, even in the absence of a specific

its arbitration complaint, complained about the demands made by Trustee and M-666 to be paid pursuant to the Promissory Note:

> As DDI has itself noted in its February 9, 1995 letter to [Nauru], DDI believes that, if there had been no delays on the Project, [one] $1,600,000 payment on this promissory note would have been due and payable in April of 1994, and another $1,600,000 would have been due and payable on or about April 1995. As such, [Nauru] asserts that DDI's failure to perform under the terms of the Development Agreement and fraud against [Nauru] have subjected

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submission of the issue. The Fifth Circuit wrote with respect to the notice claim:

> We sympathize with Valentine, as Donau wrote a broad notice of arbitration that seems to give the arbitrators jurisdiction over anything under the sun relating to the joint venture agreement. The parties agreed to arbitration, however, and must accept the loose procedural requirements along with the benefits which arbitration provides. An arbitrator in his discretion, may choose not to address an issue without giving the opposing party better notice and an opportunity to respond. Federal law, however, does not impose any requirements as to how specific a notice of arbitration must be. In the absence of a congressional mandate, we will not develop a code of pleading here.

Valentine Sugars, 981 F.2d at 213.

As both Nauru's arbitration complaint and DDI's arbitration counter-claim made reference to a dispute regarding payments due under the promissory note, *See infra* pages 14-15, the Magistrate Judge concludes that both parties had sufficient notice that Nauru's liability on the promissory notes was an issue that could be decided by the arbitration panel.

> [Nauru] have subjected [Nauru] to potential liability under the terms of the promissory note. . . .

Nauru Phosphate Royalties (Texas), Inc.'s Demand for Arbitration and Arbitration Complaint Against Drago Daic Interests, Inc. at page 45, Arbitration Record, Volume 1.[4]

Second, there is evidence that on February 9, 1995, DDI, Trustee, and M-666 made a letter demand upon Nauru for payment under the Promissory Note, citing Nauru's failure to comply with the Development Agreement as the reason sufficient cash flow had not been generated to allow for payments under the Promissory Note. In the letter DDI, Trustee, and M-666 wrote:

> Accordingly, considering the foregoing, the following numerous breaches of the rights of Drago Daic Interests, Inc., Drago Daic, Trustee, and Montgomery 666, Limited have occurred, or will soon occur, pursuant to this course of action (such breaches being of the Development Agreement between Drago Daic Interests, Inc. and Nauru (Texas), Inc. and of the Promissory Note (which incorporates the Development Agreement) between Drago Daic, Trustee and Montgomery 666, Ltd. and Nauru (Texas)):
>
> *Breach of contract:* Nauru has failed and refused to cooperate in advancing previously approved

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[4] Included in the arbitration record are three yellow files containing the parties' arbitration pleadings and notices regarding the scheduled arbitration. These files will be referred to herein as Arbitration Record, Volumes 1-3.

> budget expenditures to be utilized for development of the project and return of revenue (from which the note would be paid and the project profits realized). This is required by the Development Agreement and (by incorporation of the Development Agreement into the Promissory Note) required by the Promissory Note. This is an actual breach of both the Development Agreement with Drago Daic Interests, Inc. and the Promissory Note with Drago Daic, Trustee and Montgomery 666, Limited.

This February 9, 1995 letter was attached to DDI's arbitration counterclaim, and was thereby made part of the arbitration record. Response of Drago Daic Interests, Inc. to Complaint of Nauru Phosphate Royalties (Texas), Inc. and Counterclaim, Exhibit A, page 9, Arbitration Record, Volume 1.

Third, there is testimony from representatives of both Nauru and DDI regarding Nauru's liability under the Promissory Note, which arose pursuant to the provisions of the Development Agreement. Charles Ackerman and Kirk Breiterwischer, witnesses for Nauru, testified at the arbitration about Nauru's contingent liability under the Promissory Note. Testimony of Charles Ackerman, Arbitration Transcript, Volume 9, pages 9-26, Volume 15, pages 149-153, 192-195; Testimony of Kirk Reitenwischer, Arbitration Transcript, Volume 2, pages 108-118. According to Ackerman, payments were due under the Promissory Note when certain cash flow conditions were met. Testimony of Charles Ackerman, Arbitration Transcript, Volume 9, pages 9-26; Volume 15, pages 149-153, 192-195. Because these cash flow conditions were not met, no payment was made on the Promissory Note in 1994 and

1995. Ackerman also testified at the arbitration that because Nauru had the right to modify or terminate the development at any time, neither Trustee nor M-666 had a valid complaint about not being paid on the Promissory Note in 1994 and 1995, two years in which the cash flow conditions set forth in the Development Agreement were admittedly not met. Essentially Ackerman maintained that because Nauru had the sole discretion under section 4.6 of the Development Agreement[5] to modify and/or terminate the development plans, neither Trustee nor M-666 could validly complain that development was not proceeding at a rate which would have insured that payments could be made on the Promissory Note. Testimony of Charles Ackerman, Arbitration Transcript, Volume 9, pages 9-26.

Michael Barsi, the President of DDI, testified at the arbitration regarding the payments that were to be made on the promissory note as well as the contingent nature of those payments. According to Mr. Barsi, payments were to be "based on the availability for distribution of cash

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[5] Section 4.6 of the Development Agreement provides:

> Owner shall have the right at any time to make any changes in the Operating Plans necessary or advisable in Owner's sole discretion based upon the performance of the Project, the progress of the development work, or economic factors affecting the Project, including the right to cease development and stop or suspend all work on the Project, and may take all steps necessary, in its sole discretion, to protect the value of its investment in the Property.

Development Agreement, DDI Exhibits Volume 1, #15, at 33.

flow as set forward – set forth in the Development Agreement." Testimony of Michael Barsi, Arbitration Transcript Volume 20, pages 118-119, 188-193.

Mr. Robert Higgs, in-house counsel for DDI, also testified at the arbitration regarding the claims against Nauru on the Promissory Note. According to Higgs, but for Nauru's actions with respect to the development as well as Nauru's failure to fulfill its obligations under the Development Agreement, "there would have been sufficient cash flow to have made one, if not two note payments in the amount of $1.6 million each." Testimony of Robert Higgs, Arbitration Transcript, Volume 48, pages 274-275.

Given this evidence in the record which reveals the parties' understanding of the interrelatedness of the Development Agreement and the Promissory Note, DDI, Trustee, and M-666 cannot complain that they had no notice that issues related to the Promissory Note would be resolved in the arbitration.[6] As Nauru's liability on the Promissory Note was raised and argued by both sides during the arbitration, the arbitration panel did not exceed its authority in deciding the issue.

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[6] It must be noted that while Trustee and M-666 are the parties to the Promissory Note and are the only parties which have a valid interest in the findings of the arbitration panel with regard to the Promissory Note, neither is a party to the instant suit.

D. The arbitration panel's finding is binding upon Trustee and M-666

In addition to concluding that the arbitration panel did not exceed its authority in resolving the dispute over the Promissory Note, the Magistrate Judge also concludes that the arbitration panel's decision, that Nauru is not liable for payment on the Promissory Note, is binding upon Trustee and M-666 because the Development Agreement contains a broad arbitration clause. Trustee and M-666 did not sign the entire Development Agreement,[7] but they did agree to be bound by the terms of the Development Agreement by signing the Promissory Note, which incorporated the Development Agreement *in toto*. *See* page 12, *supra*. The Development Agreement, including its provision for arbitration of "any dispute, controversy or claim arising out of or in connection with or relating to" the Development Agreement was incorporated into the Promissory Note as if fully set forth in the Promissory Note and was intended to reach all aspects of the parties' agreement. Section 13 – Dispute Resolution of Development Agreement, DDI Exhibits Vol. I, #15 at 63-64 (emphasis added), also attached to Nauru's Motion

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[7] Both Trustee and M-666 signed the Development Agreement, but signed the agreement only with respect to section 3.7 and Article 5. Development Agreement, DDI Exhibits Vol. 1, #15, at page 69, and page 69 of Exhibit "A", attached to Nauru's Motion to Confirm Arbitration Award (Document No. 1). Trustee and M-666 seemingly attempted to limit their adoption of the Development Agreement to section 3.7 and article 5. Nevertheless, the Promissory Note, signed by bith [sic] Trustee and M-666, fully incorporated the Development Agreement.

to Confirm Arbitration Award as Exhibit "A"; Promissory Note, DDI Exhibits Vol. 1, #5 at page 1.

Given the incorporation of the Development Agreement into the Promissory Note, both Trustee and M-666 were bound by the global arbitration clause in the Development Agreement. *Heinhuis v. Venture Assoc.*, 959 F.2d 551 (5th Cir. 1992) (holding that parties to an excess insurance policy, which incorporated by reference the underlying insurance policy, were bound by the arbitration clause contained in the underlying insurance policy); *J.S. & H. Construction Co. v. Richmond County Hosp. Authority*, 473 F.2d 212, 216 (5th Cir. 1973) (holding that parties to a subcontract which incorporated by reference the general contract were bound by the arbitration clause contained in the general contract); *Progressive Casualty Ins. Co. v. C.A. Reaseguradora Nacional*, 991 F.2d 42, 46 (2nd Cir. 1993) (holding that parties to an agreement agreed to arbitrate their disputes when they incorporated by reference a related agreement which contained an arbitration clause); *Exchange Mutual Ins. Co. v. Haskell Co.*, 742 F.2d 274, 276 (6th Cir. 1984) (a performance bond which incorporates by reference a subcontract which in turn incorporates by reference a general contract, in which there is an arbitration clause, obligates the parties to the performance bond to arbitrate their disputes in accord with the provisions of the general contract's arbitration clause); *Hoffman v. Fidelity & Deposit Co. of Maryland*, 734 F.Supp. 192 (D. N.J. 1990) (holding that when an agreement which contains a broad arbitration clause is incorporated by reference into a related agreement, the parties to the related agreement are obligated to arbitrate their disputes); and *Cianbro Corp. v. Empresa Nacional de Ingenieria,*

697 F.Supp. 15, 18 (D. Me. 1988) ("Because the surety's bond clearly incorporates the subcontract terms by reference, and the incorporated subcontract contains a mandatory arbitration clause, the surety is bound to arbitrate"). Because the Promissory Note incorporated the terms of the Development Agreement without limitation, both Trustee and M-666 were bound by the terms of the arbitration clause contained in the Development Agreement. As such, both Trustee and M-666 are bound by the findings of the arbitration panel.

The fact that neither Trustee nor M-666 participated in the arbitration does not alter this conclusion. There is nothing in the arbitration record to indicate that Trustee and M-666 were precluded from participating in the arbitration. Rather, there is evidence in the arbitration record that DDI, which did participate in the arbitration, had the same interests at stake as Trustee and M-666. Specifically, DDI alleged in the arbitration that Nauru had breached certain of its obligations under the Development Agreement. Response of Drago Daic Interests, Inc. to Complaint of Nauru Phosphate Royalties (Texas), Inc. and Counterclaim, Arbitration Record, Volume 1. Such breaches, DDI and its witnesses alleged, resulted in a lack of cash flow from which payments on the Promissory Note were to be made, thereby resulting in damages to Trustee and M-666. Exhibit A to Response of Drago Daic Interests, Inc. to Complaint of Nauru Phosphate Royalties (Texas), Inc. and Counterclaim, Arbitration Record, Volume 1; Testimony of Robert Higgs, Arbitration Transcript, Volume 48, pages 274-275. There is also evidence in the arbitration record that Drago Daic, the man behind DDI, Trustee, and

M-666,[8] fully participated in the arbitration proceedings.

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[8] Evidence was presented at the arbitration that:

1. Drago Daic is the sole owner of DDI. Testimony of Michael Barsi, Arbitration Transcript, Volume 17, page 88.
2. Drago Daic, Trustee represents the 3-D Trust, a verbal trust established by Drago Daic for his children and grandchildren. Testimony of Michael Barsi, Volume 17, page 105, Testimony of Robert Higgs, Arbitration Transcript, Volume 47, page 252, and Testimony of Drago Daic, Arbitration Transcript, Volume 53 pages 160-164.
3. The land which was sold to Nauru for the development was initially purchased by Drago Daic in 1983 for approximately $3.8 million. Testimony of Charles Ackerman, Arbitration Transcript, Volume 9, pages 36-38 and Testimony of Michael Barsi, Arbitration Transcript, Volume 18, pages 9-17.
4. Within thirty days of purchasing the land, Drago Daic sold the land in equal 50% shares and at a substantial profit to Drago Daic, Trustee and Montgomery 666, Ltd. Testimony of Michael Barsi, Arbitration Transcript, Volume 18, pages 9-17 and Testimony of Robert Higgs, Arbitration Transcript, Volume 47, pages 250-257.
5. Drago Daic, Trustee and Montgomery 666, Ltd. entered into a joint venture agreement with respect to the land, with Drago Daic acting as managing joint venturer. Testimony of Charles Ackerman, Arbitration Transcript, Volume 9, pages 36-38 and Testimony of Michael Barsi, Arbitration Transcript, Volume 18, pages 15-18.
6. Fifty-five percent (55%) of Montgomery 666, Ltd. is owned by Revista, Inc., a company which is in turn owned by the 3-D Trust and effectively

See Testimony of Drago Daic. Arbitration Transcript, Volume 51, pages 51 to end; Volume 52, pages 202 to end; Volume 53, pages 1 to end; and Volume 54, pages 1 to 183. His participation in the arbitration proceeding served to protect the interests of Trustee and M-666. *See e.g., Isidor Paiewonsky Assoc., Inc. v. Sharp Properties, Inc.*, 998 F.2d 145, 155 (3rd Cir. 1993) (holding that an arbitration award may be enforced against a party which did not participate in the arbitration as long as one of the parties to the arbitration had related and congruent interests which were properly advanced during the arbitration).[9] The

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controlled by Drago Daic. Testimony of Michael Barsi, Arbitration Transcript, Volume 17, pages 112-114 and Testimony of Drago Daic, Arbitration Transcript, Volume 53, pages 160-164.

7. Another company owned and controlled by Drago Daic, Imperial Marketing, owns 19.33% of Montgomery 666, Ltd. Testimony of Michael Barsi, Arbitration Transcript, Volume 17, pages 113-115.

8. Drago Daic, individually, or Drago Daic in his capacity as the 3-D Trustee, owns 75% interest in the Promissory Note between Nauru, Trustee, and M-666. Testimony of Michael Barsi, Arbitration Transcript, Volume 17, pages 114-155 and Testimony of Drago Daic, Arbitration Transcript, Volume 53, pages 160-164.

[9] In *Isidor Paiewonsky Assoc. Inc. v. Sharp Properties, Inc.*, 998 F.2d 145 (3rd Cir. 1993), a subtenant challenged the enforceability of an arbitration award, arguing that because he was not a party to the arbitration agreement, his rights could not be affected by the arbitration award. The dispute in *Isidor* began as a dispute between two adjacent property owners over an easement. The case, however, evolved into a dispute between one of the landowners, Sharp, and the main tenant of one of its

similarity of interests between Drago Daic, DDI, Trustee, and M-666 on the issues presented at the arbitration, allows for the enforcement of the arbitration award against Trustee and M-666, even though they did not directly participate in the arbitration. *See Pritzker v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110, 1122 (3rd Cir. 1993) ("[A]rbitration agreements may be upheld against non-parties where the interests of such parties are directly related to, if not congruent with, those of a signatory"); *See also Isidor Paiewonsky Assoc. Inc. v. Sharp Properties, Inc.*, 998 F.2d 145, 155 (3rd Cir. 1993); *Barrowclough v. Kidder, Peabody & Co., Inc.*, 752 F.2d 923, 937-38 (3rd Cir. 1985), *overruled on other grounds*, 7 F.3d 1110 (3rd Cir. 1993).

Because the Development Agreement was incorporated into the Promissory Note, both Trustee and M-666 were bound by the arbitration clause contained in the Development Agreement. Moreover, despite Trustee and M-666's failure to participate in the arbitration, the interests of Trustee and M-666 were well represented by DDI, whose interests were similar, if not identical. Under the applicable law, discussed above, the Magistrate Judge

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commercial buildings, ARI. The dispute between Sharp and ARI proceeded to arbitration pursuant to the parties' agreement to arbitrate their disputes. Pursuant to the arbitration award, one of ARI's subtenants, Bared Jewelers, was evicted. Bared Jewelers challenged the eviction, claiming that it could not be bound by an arbitration proceeding to which it was not party. In determining that the arbitration award could be enforced against Bared, the Third Circuit Court of Appeals concluded ARI, which had interests either related or identical to Bared's, sufficiently advanced arguments and evidence at the arbitration proceeding which protected Bared's interests.

concludes from these facts that both Trustee and M-666 are bound by the arbitration award, including the arbitration finding that Nauru is not liable on the Promissory Note. The arbitration award is enforceable against Trustee and M-666.

E. The arbitration panel's decision on the Promissory Note should be confirmed

The arbitration panel's decision that: "NPR [Nauru] has no liability for payment of the eight million dollar Promissory Note executed by NPR [Nauru] and payable to Drago Daic, Trustee and Montgomery 666 Ltd." should be confirmed. The arbitration panel neither exceeded its authority in making such a finding nor violated the rights of Trustee and M-666 with such a finding. There is no other basis under the Federal Arbitration Act for the vacation and/or modification of this finding, and the finding should be upheld.

VI. Issue 2: Porter MUD

A. The Arbitration Panel's Finding

The Arbitration panel concluded with respect to the Porter MUD issue that DDI was responsible for Nauru's loss of reimbursement funds for 122 lots located in the Porter Municipal Utility District. That loss was calculated by the arbitration panel at $477,000.

B. The Parties' Arguments

DDI objects to the arbitration panel's decision on the Porter MUD issue on the basis that the Development Agreement did not allow for such a loss reimbursement, but rather provided for an offset against other amounts due under the Development Agreement and Promissory Note. Accordingly, DDI argues that the arbitration panel exceeded its authority by disregarding the clear provisions of the Development Agreement. Additionally, DDI argues that even if reimbursement is allowed under the Development Agreement, the arbitration panel erred in calculating the amount of reimbursement due because the Development Agreement provided that DDI was only responsible for one half of the reimbursement amount.

In response to DDI's arguments, Nauru suggests that the arbitration panel correctly concluded that the provision in the Development Agreement, which allowed for offsets of reimbursement losses, contemplated reimbursement losses associated with the creation of a Bentwater municipal utility district, not reimbursement losses associated with the Porter municipal utility district. According to Nauru, at the time the Development Agreement was signed, it was unaware that some of the property in the development was part of an existing municipal utility district, the Porter municipal utility district. As a result, the provision in the Development Agreement allowed for offsets of expenses applied to a municipal utility district which was to be created, not one that was already in existence. Thus, Nauru argues that the arbitration panel did not exceed its authority, but rather was well within its authority in interpreting the terms and conditions of the Development Agreement.

C. Reimbursement of MUD expenses

In general, certain expenses associated with the creation of a municipal utility district (MUD) are reimbursable. The usual procedure for reimbursement was discussed by W. James Murdaugh, Jr. and Gerald Munger during the arbitration. Testimony of W. James Murdaugh, Jr., Arbitration Transcript, Volume 30, pages 191-213; Testimony of Gerald Munger, Arbitration Transcript, Volume 40, pages 6-8. According to Murdaugh, usually 70% of the cost associated with the construction of water lines, sewage collection lines, drainage lines, and storm drainage lines is reimbursable. Testimony of W. James Murdaugh, Jr., Arbitration Transcript, Volume 30, pages 191-213. The Development Agreement provided with respect to this expected MUD expense reimbursement:

> It is anticipated that certain drainage, wastewater treatment, water purification and other utility facilities (the "Utility Improvements") will be required to be constructed on the Property in connection with the Project. Developer expects that the Municipal Utility District ("M.U.D.") to be formed to operate such Utility Improvements will purchase the Utility Improvements at a price equal to seventy percent (70%) of the cost incurred in constructing such Utility Improvements. All costs incurred in connection with the construction and provision of the Utility Improvements less all monies paid by the M.U.D. for Utility Improvements shall constitute Project Expenses. In the event the amount paid by the M.U.D. is less than 70% of the cost incurred in providing the Utility Improvements, Owner shall have the right to deduct and retain fifty percent (50%) of such

> shortfall from any distribution of Cash Flow next due Developer or any Affiliate of Developer (including any monies due Drago Daic, Trustee as 50% holder of the Promissory Note) under Section 5.1 whether such distributions constitute payment of principal under the Promissory Note or the Development Fee. In no event shall the amount due Owner from Developer under this Section 5.3 be considered a Project Expense.

Development Agreement, DDI Exhibits Vol. 1, #15 at 38-39.

D. The finding on the Porter MUD issue did not exceed the arbitration panel's authority

It is clear from the parties' arguments and the evidence submitted during the arbitration that some of the development property is located in an existing municipal utility district, the Porter MUD, while the rest of the property is in a municipal utility district created specifically for the development, the Bentwater MUD. Testimony of W. James Murdaugh, Arbitration Transcript, Volume 30, page 225. The arbitration panel's implicit conclusion that section 5.3 of the Development Agreement (which allowed for offsets of reimbursement losses) did not apply to reimbursement losses associated with an existing municipal district, is an interpretation of the Development Agreement that the arbitration panel was allowed to make. As its implicit conclusion is rationally inferable from the letter or purpose of the underlying agreement, the arbitration panel, regardless of the legal correctness of the conclusion, did not exceed its authority.

See Executone Information Systems, Inc. v. Davis, 26 F.2d 1314, 1320 (5th Cir. 1994) ("We must sustain an arbitration award even if we disagree with the arbitrator's interpretation of the underlying contract as long as the arbitrator's decision 'draws its essence' from the contract"); *See also United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29, 37-38 (1987) ("Because the parties have contracted to have disputes settled by an arbitrator chosen by them rather than a judge, it is the arbitrator's view of the facts and of the meaning of the contract that they have agreed to accept. Courts thus do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts"). Given the dictates of *United Paperworkers* and *Executone*, and given that the arbitration panel had the authority to interpret and apply the provisions of the Development Agreement, including the provision for MUD expense reimbursement, the Court cannot vacate or modify this portion of the arbitration award.

With respect to the calculation of the damages associated with the reimbursement loss, testimony and evidence were offered at the arbitration which supported the arbitration panel's decision that Nauru was due $477,000 in reimbursement losses. Evidence was offered that the development of sewer facilities would cost $492,000. Testimony of Charles Ackerman, Arbitration Transcript, Volume 6, page 244. The arbitration panel used this figure, less $15,000 in associated annexation costs, and arrived at a reimbursable cost of $477,000. Arbitration award at 6, attached to Nauru's Motion to Confirm Arbitration Award (Document No. 1) as Exhibit "C". Because the

award is supported by evidence presented to the arbitration panel, and because the arbitration panel implicitly rejected the application of section 5.3 to the reimbursement losses associated with property in the Porter MUD, the Court cannot conclude that the arbitration panel miscalculated the award. The arbitration decision related to the Porter MUD issue should be confirmed.

VII. Issue 3: Drainage Ditch Overruns

A. The Arbitration Panel's Finding

The arbitration panel concluded that DDI was responsible for cost overruns incurred in excavating the drainage ditch, including $597,151.00 in payments made to LeCon and $150,950.00 in payments to Nasr resulting from "DDI's management decision to place dirt at sewer treatment place site". Arbitration Award at 4, attached to Nauru's Motion to Confirm Arbitration Award (Document No. 1) as Exhibit "C".

B. The Parties' Arguments

DDI argues that the arbitration panel's decision that it should reimburse Nauru for cost overruns on the drainage ditch excavation is contrary to waiver principles established in Texas. According to DDI, Nauru waived any right it may have had to complain about cost overruns on the drainage ditch, when it failed to object to a management decision made by DDI regarding the excavation. DDI explains that initially the dirt removed from the drainage ditch was to be placed in designated interior spoil sites which would allow the dirt to be used in the

construction of the golf course. When heavy rains impeded the excavator's ability to place the dirt in the designated areas, DDI decided to have the dirt placed at perimeter spoil sites. This allowed the drainage ditch to be completed on time, but also necessitated a second move of the dirt, resulting in significant cost overruns. DDI maintains that Nauru knew about its management decision to change the location where the dirt was to be placed, and did not object to the plan. DDI further argues that Nauru, in paying the excavator for its completion of the drainage ditch, released the excavator from any further liability arising out of the excavation of the ditch. DDI asserts that by these actions Nauru waived any right it may have had to complain about the excavation of the ditch and the associated cost overruns.

In response to DDI's arguments, Nauru points out that DDI's waiver argument and associated evidence was presented to the arbitration panel. The fact that the arbitration panel did not arrive at the conclusion DDI wanted with respect to the waiver issue is not evidence that the arbitration panel disregarded Texas law on the issue of waiver. Rather, a reasonable interpretation of the arbitration panel's decision is that in applying Texas waiver law to the facts of the case, the arbitration panel concluded that waiver had not occurred.

C. The arbitration panel's decision on the drainage ditch overruns and expenses should be confirmed

Although DDI argues that the arbitration panel exceeded its authority by ruling against it on the issue of

waiver, the decision of the arbitration panel on this issue should be confirmed under the principles announced in *Executone, Baton Rouge Oil,* and *United Paperworkers, supra.* As long as an arbitration award "is rationally inferable from the letter or purpose of the underlying agreement," the award should be upheld regardless of alleged errors of law or fact. *Executone,* 26 F.3d at 1320.

There is no evidence in the record and no indication from the arbitration award itself that the arbitration panel ignored controlling Texas law on the issue of waiver. Rather, a reasonable inference from the arbitration award is that the panel attributed the cost overruns on the drainage ditch to the developer, DDI, which was found to have mismanaged the development project in several material respects. Under section 3.1(b) of the Development Agreement, DDI was to act as the general contractor on the project. See Section 3.1(b) of the Development Agreement, DDI Exhibits Vol. 1, #15 at 12. Moreover, under Section 6.1(c) of the Development Agreement, DDI could be held responsible for cost overruns on the project. Section 6.1(c) provides:

> If an Operating Budget overrun is determined by arbitration, in accordance with Section 13, to be attributable to Developer's failure to perform its obligations in accordance with the requirements and standards herein, Developer shall bear the excess of Project Expenses over Authorized Expenses.

See Section 3.1(b) of the Development Agreement, DDI Exhibits Vol. 1, #15 at 43. As the arbitration panel's authority to allocate responsibility for the cost overruns is directly provided for in section 6.1(c) of the Development

Agreement, and as the arbitration panel acted pursuant to this authority when it determined that the cost overruns were attributable to DDI, this Court cannot, under the authority of *Executone, Baton Rouge Oil* and *United Paperworkers,* disturb the arbitrators' decision. The arbitration award in favor of Nauru on the drainage ditch overruns should be confirmed.

VIII. Issue 4: Clubhouse Overruns, Repairs and Liens

A. The Arbitration Panel's Finding

The Arbitration panel concluded that DDI was liable for cost overruns on the clubhouse in the amount of $33,742.46, additional repairs to the clubhouse in the amount of $43,700, and liens on the clubhouse in the amount of $39,649.15.[10]

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[10] The arbitration panel awarded specific damages associated with the clubhouse:

a. *Damages to Third Party Work to Complete Clubhouse*
$33,742.46
Reason: $173,946.46 cost paid to third parties to substantially complete clubhouse was offset by $140,204.00 savings on the Nasr clubhouse construction contract

b. *Additional Repairs to Clubhouse*
$43,700.00
Reasons: The $43,700.00 award is comprised of the following elements:

(1)	windows and repainting	$25,000.00
(2)	roof repair	$5,000.00
(3)	sidewalk repair	$12,000.00
(4)	air handling in cart storage area	$1,700.00

No damages awarded for the remaining complaints for repairs.

B. The Parties' Arguments

DDI essentially argues that the arbitration panel exceeded its authority when it determined that DDI was responsible for cost overruns and repairs on the clubhouse. Although DDI concedes that the Development Agreement contains language which may be construed as designating DDI the general contractor on the project, DDI contends that all evidence before the arbitration panel supported the conclusion that Nauru was the de facto general contractor, having signed all the contracts for the construction of the clubhouse. According to DDI, because it was not the de facto general contractor, it could not have been liable for cost overruns on the clubhouse, additional repairs on the clubhouse, and liens placed by subcontractors on the clubhouse. Additionally, DDI argues that the repair costs assessed by the arbitration panel were excessive and therefore the arbitration panel miscalculated the damage award.

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c. *Damages for Cost to Complete Halfway Houses in Excess of Contract Amount*
$9,404.41

d. *Damages for M&M Liens on Clubhouse*
The Arbitrators give DDI 120 days from the date of this award to settle and obtain executed and notarized releases for the following 4 liens outstanding against the clubhouse:
(1) Coburn Supply Co. $1,535.77
(2) Joyces Plastering Co., Inc. $8,076.00
(3) Liberty Mechanical Corp. $26,946.68
(4) Casteel Auto, Fire Protection $3,090.70

Arbitration Award at 5, attached to Nauru's Motion to Confirm Arbitration Award (Document No. 1) as Exhibit "C".

In response to DDI's argument, Nauru points to section 3.1 of the Development Agreement, which provided "[t]he Developer shall act as the general contractor for the Project." Given this provision in the Development Agreement, Nauru maintains that the arbitration panel clearly did not err in determining that DDI, as the general contractor, was responsible for cost overruns, additional repairs, and subcontractors' liens. With respect to amount awarded for repairs, Nauru points to evidence in the arbitration record which supports the amounts the arbitration panel assessed for certain repairs to the clubhouse.

C. The arbitration panel's decision on the cost overruns and expenses on the clubhouse should be confirmed

DDI was the general contractor on the project under the clear terms of the Development Agreement. Additionally, the arbitration panel, pursuant to section 6.1(c) of the Development Agreement, was explicitly given authority to attribute cost overruns to DDI in the event such cost overruns were the result of DDI's failure to fulfill its obligations under the Development Agreement. This, the arbitration panel did, when it concluded that DDI was responsible for the cost overruns on the clubhouse, the additional repairs which were needed on the clubhouse, and the liens which were placed on the clubhouse. The arbitration panel did not exceed its authority in determining that DDI was responsible for the cost overruns, repair expenses, and liens on the clubhouse.

There is sufficient evidence in the arbitration record to support the arbitration panel's calculation of damages associated with the clubhouse and the needed repairs. Testimony of Charles Ackerman, Arbitration Transcript, Volume 7, pages 26-28, 227, Volume 9, page 97, Volume 16, page 159; Testimony of Jeff Presnal, Arbitration Transcript, Volume 30, pages 63-95. Unless there is an obvious miscalculation, *McIlroy v. Painwebber* [sic], *Inc.*, 989 F.2d 817, 821 (5th Cir. 1993), this Court cannot, under the authority of *Executone, Baton Rouge Oil* and *United Paperworkers*, disturb the arbitrators' decision. The arbitration award in favor of Nauru on the clubhouse overruns, repairs and liens should be confirmed.

IX. Issue 5: Attorney's Fees

A. The Arbitration Panel's Finding

The arbitration panel awarded Nauru $393,283.50 in attorney's fees. Arbitration Award at page 6, attached to Nauru's Motion to Confirm Arbitration Award (Document No. 1) as Exhibit "C".

B. The Parties' Arguments

DDI argues that in the event the arbitration award is in any respect modified the attorney's fee award should also be modified so that it is reasonably related to the arbitration award. In response to DDI's summary argument regarding attorney's fees, Nauru contends that DDI has provided no basis, and indeed there is none, for a modification of the attorney's fee award.

C. The arbitration panel's decision on the attorneys' fees should be confirmed

Section 14.6 of the Development Agreement makes provision for attorneys' fees:

> If a suit or action is instituted in connection with any controversy arising out of this Agreement or to enforce or interpret any rights hereunder, the prevailing party shall be entitled to recover all costs and expenses, including, without limitation, reasonable attorneys' fees and all costs and expenses in connection with investigation, defense, and settlement of such controversy, in addition to all other amounts allowed by law.

As Nauru prevailed at arbitration, the arbitration panel, pursuant to section 14.6 of the Development Agreement, awarded Nauru attorneys' fees in the amount of $393,383.50. This award constituted an implicit finding that $393,383.50 represented Nauru's reasonable attorneys' fees. The arbitration panel did not exceed its authority in making such an award. This Court, under the dictates of *Executone*, *Baton Rouge Oil* and *United Paperworkers*, *supra*, cannot disturb that award. Thus, the attorneys' fee award should be confirmed.

X. Conclusion

Based on the foregoing, the Magistrate Judge concludes that Defendant Drago Daic Interests, Inc. has come forth with no viable basis for the vacation and/or modification of any portion of the arbitration award at issue in this case. The Magistrate Judge RECOMMENDS that Defendant Drago Daic Interests, Inc.'s Motion to Modify

or Vacate Arbitration Award (Document No. 10) be DENIED in its entirety. Moreover, the Magistrate Judge RECOMMENDS that Nauru Phosphate Royalties (Texas), Inc's Motion to Confirm Arbitration Award in Support of Final Judgment (Document No. 1) be GRANTED.

The Clerk shall file this instrument and provide a copy to all counsel and unrepresented parties of record. Within 10 days after being served with a copy, any party may file written objections pursuant to 28 U.S.C. § 636(b)(1)(C), Fed. R. Civ. P. 72(b), and General Order 80-5, S.D. Texas. Failure to file objections within such period shall bar an aggrieved party from attacking factual findings on appeal. *Thomas v. Arn*, 474 U.S. 140 (1985); *Ware v. King*, 694 F.2d 89 (5th Cir. 1982), *cert. denied*, 461 U.S. 930 (1983); *Nettles v. Wainwright*, 677 F.2d 404 (5th Cir. 1982) (en banc). Moreover, absent plain error, failure to file objections within the ten day period bars an aggrieved party from attacking conclusions of law on appeal. *Douglass v. United Services Automobile Association*, 79 F.3d 1415, 1429 (5th Cir. 1996). The original of any written objections shall be filed with the United States District Clerk, P.O. Box 61010, Houston, Texas 77208 and a copy must be delivered to the Chambers of Judge Werlein, Jr., Room 9136 and to the Chambers of Magistrate Judge Stacy, Room 7727, Federal Building, 515 Rusk, Houston, Texas 77002.

Signed at Houston, Texas, this 3rd day of February, 1997.

/s/ Frances H. Stacy
FRANCES H. STACY
UNITED STATES
MAGISTRATE JUDGE

APPENDIX E

AMERICAN ARBITRATION ASSOCIATION
CAUSE NO. 70 199 0033 95K

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.	)	BEFORE A PANEL OF ARBITRATORS HOUSTON, TEXAS
VS.	)	PURSUANT TO THE RULES OF THE AMERICAN ARBITRATION ASSOCIATION
DRAGO DAIC INTERESTS, INC.	)	

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AWARD OF ARBITRATORS

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The arbitration panel of Judge Ross Sears (party arbitrator appointed by Drago Daic Interest, Inc.), Charles J. Jacobus, Sr. (party arbitrator appointed by Nauru Phosphate Royalties (Texas), Inc.) and Patrick T. Sharkey (designated neutral arbitrator), collectively called the "Arbitrators", have considered the pleadings, evidence, arguments, and documentary exhibits and have made the following conclusions and awards:

I. FRAUD IN INDUCEMENT TO PURCHASE PROPERTY

The Arbitrators find no fraud in the inducement. The arbitrators find that Nauru Phosphate Royalties (Texas), Inc. ("NPR") relied on the advice of its own advisor, Ken Walker, in making the acquisition of the subject property.

II. FRAUD IN INDUCEMENT TO DEVELOP THE LAND

The Arbitrators find no fraud on DDI's part in inducing NPR to continue with the development of Bentwood. NPR chose to ignore the advice of its local representatives, Kirk Breitenwischer and Charles Ackerman and elected to proceed with the development of Bentwood.

III. BREACH OF CONTRACT

The Arbitrators have considered each of allegations regarding breaches of contract raised by both parties and have found the following breaches of contract to have occurred:

A. Breaches of Contract by DDI

1. Sec. 3.1(b) failure to provide on-site management,
2. Sec. 3.1(c) failure to provide three candidates for project engineer,
3. Sec. 3.1(d) failure to provide three candidates for project architect,
4. Sec. 3.1(e) failure to competitively bid each contract and failure to properly select contractors,
5. Sec. 3.1(g) failure to properly supervise the project,
6. Sec. 3.1(h) failure to verify the accuracy of draw requests,
7. Sec. 3.1(k) failure to prepare and submit marketing plan,

8. Sec. 3.2 failure to exercise good faith standard of performance,

9. Sec. 3.6(b) by allowing liens on the property,

10. Sec. 3.7 filing a list pendens on the property and failing to provide the required releases on Lot 15,

11. Sec. 6.1(b) failing to adhere to its approved operating budget,

12. Sec. 6.1(c) failure to submit changes of operating budgets,

13. Sec. 8.1(b) failure to return NPR's books and records.

B. Breaches of Contract by NPR

1. Sec. 6.1(b) failure to fund timely,

2. Sec. 4.5 failure to timely provide job description for NPR's local representative,

3. Sec. 7.1(a) failure to pay initial funds of $400,000 within 20 days of the date of the Development Agreement.

Notwithstanding the Arbitrator's findings of breaches of the Development Agreement by NPR, the Arbitrators determined the NPR's breaches were not material and resulted in no damages to DDI. On the other hand, the Arbitrators concluded that DDI's breaches of the Development Agreement were material and resulted in damages to NPR as further set out in this Arbitration Award.

IV. DECLARATORY JUDGMENT REGARDING TERMINATION OF DEVELOPMENT AGREEMENT

The Arbitrators find that NPR's termination of the Development Agreement as of March 31, 1995 was with cause. Consequently, the Arbitrators find that (i) the Development Agreement was properly terminated, (ii) NPR has not further duties to DDI under the terms of the Development Agreement, and (iii) NPR has not liability for payment of the eight million dollar promissory note executed by NPR and payable to Drago Daic, Trustee and Montgomery 666, LTD.

V. INDEMNIFICATION

The Arbitrators find that NPR is entitled to indemnification by DDI for all costs, including attorney's fees and court costs incurred by NPR in connection with the *Williford, et al. v. Drago Daic, Individually and as Trustee, et al.*, Cause No, 93-03-00876-CV in the District Court of Montgomery County, Texas, 221st Judicial District lawsuit. Conversely, the Arbitrators find that NPR has no duty to indemnify DDI under Section 12 of the Development Agreement. The Arbitrators further find that the Developer's Interest under Section 11 of the Development Agreement is $0.00. The Arbitrators further find that no indemnification for either party is warranted under Sec.12 of the Development Agreement in connection with the *Drago Daic, Trustee and Montgomery, 666 LTD. v. Nauru Phosphate Royalties (Texas), Inc. and Bentwood Country Club, Inc.*, Cause No. 95-03-00842-CV in the district court of Montgomery County, Texas, 2nd Ninth Judicial District.

VI. NEGLIGENT MISREPRESENTATION

The Arbitrators find no negligent misrepresentation by DDI. There is no evidence in the record that shows reliance.

VII. DAMAGES

In assessing damages to be awarded in this arbitration proceeding, the Arbitrators follow the format set fourth [sic] in NPR's Summary of Certain Damages Claimed by NPR as revised on Sep. 15, 1995. The damage awards of the Arbitrators to be paid to NPR by DDI are as follows:

A. **Fraud in Inducement to Purchase Property**

$0.00

B. **Fraud in Inducement to Develop Bentwood**

$0.00

C. **Direct Damages**

1. DRAINAGE DITCH

a. Payment to Star to Hire Gary Daic

$0.00

Reason: no evidence of damages resulting from the $35,000 payment.

b. Payments to LeCon

$597,151.00

Reason: DDI's management decision to place dirt at sewer treatment place site which resulted in cost overrun. Sec. 6.1 of the Development Agreement places

financial responsibility for cost overrun on DDI.

c. Payments to Nasr

$150,950.00

Reason: DDI's management decision to place dirt at sewer treatment place site which resulted in cost overrun. Sec. 6.1 of the Development Agreement places financial responsibility for cost overrun on DDI.

d. Fraudulent Sale of Equipment to NPR from Northeast Equipment Co. (A Gary Diac Co.)

$44,692.00

Reason: Ditch contract required contractor to supply all equipment. Therefore, DDI's authorization for payment of these funds is inappropriate. However, NPR must return the pump in its possession to DDI upon NPR's receipt of damages from DDI.

e. Costs Due to Payoff of Liens by NPR(T)

$0.00

Reason: Liens should have been paid by NPR out of Gary Diac's retainage.

f. Drainage Ditch Rework to be Completed by NRP(T)

$0.00

Reason: settlement with Star saved $149,000. No proof that the cost of reworking the ditch will exceed savings from the Star settlement.

2. CLUBHOUSE, HALFWAY HOUSES

a. Damages for Third Party Work to Complete Clubhouse

$33,742.46

Reason: $173,946.46 cost paid to third parties to substantially complete clubhouse was offset by $140,204.00 savings on the Nasr clubhouse construction contract

b. Additional Repairs to Clubhouse

$43,700.00.

Reasons: The $43,700.00 award is comprised of the following elements:

(1) windows and repainting $25,000.00;

(2) roof repair $5,000.00;

(3) sidewalk repair $12,000.00;

(4) air handling in cart storage area $1,700.00.

No damages are awarded for the remaining complaints for repairs.

c. Damages for Cost to Complete Halfway Houses in Excess of Contract Amount

$9,404.41

d. Damages for M&M Liens on Clubhouse

The Arbitrators give DDI 120 days from the date of this award to settle and obtain executed and notarized releases for the following 4 liens outstanding against the clubhouse:

(1) Coburn Supply Co. $1,535.77;

(2) Joyces Plastering Co., Inc. $8,076.00;

(3) Liberty Mechanical Corp. $26,946.68;

(4) Casteel Auto, Fire Protection $3,090.70.

On or before 120 days from the date of this award, DDI shall provide NPR with either the original fully executed and notarized releases of lien for each of the referenced liens or a cash payment in a sufficient amount to fully pay off any lien not released within the 120 day period.

3. ENTRY MONUMENT

$0.00

Reason: $10,000 payment to Nasr was in settlement of all claims. $35,000 damages request was speculative and without adequate proof.

4. DAMAGES DUE TO DELAY OF POWER INSTALLATION

$0.00

Reason: Delay in power installation was not due solely to DDI's actions.

5. LOSS OF REIMBURSEMENT FROM 122 LOTS LOCATED IN PORTER MUD

$477,000.00

Reason: $492,000.00, minus $15,000.00 for annexation costs.

6. NPR'S BOOKS AND RECORDS

$4,997.64 for copy costs and DDI is hereby ordered to return all NPR's books and records to NPR within seven (7) days after the receipt of this award.

7. WILLIFORD INDEMNITY

$33,206.56 plus all future legal fees and costs incurred by NPR as established by the 221st Judicial District Court of Montgomery County, Texas.

8. ATTORNEY'S FEES

a. NPR is awarded attorney's fees in the amount of $393,283.50.

b. DDI is awarded no attorney's fees.

9. PUNITIVE DAMAGES

$0.00

10. ARBITRATION COSTS

$0.00

Reason: Sec. 13 of the Development Agreement provides as follows: "the expenses of the arbitration shall be borne equally by the parties to the arbitration."

This Award of Arbitrators is in full settlement and resolution of all claims and counterclaims submitted in this arbitration proceeding.

The date of this award is February 9, 1996.

/s/ Ross Sears/Dist
JUDGE ROSS SEARS

/s/ Charles J. Jacobus, Sr.
CHARLES J. JACOBUS, SR.

/s/ Patrick T. Sharkey
PATRICK T. SHARKEY

On this 9th day of February, 1996, before me personally came and appeared Judge Ross Sears, Charles J. Jacobus, Sr. and Patrick T. Sharkey, to me known and known to me to be the individuals described in and who executed the foregoing instrument, and they acknowledged to me that they executed the same.

/s/ Karen Smith
NOTARY PUBLIC, STATE OF TEXAS

APPENDIX F

AMERICAN ARBITRATION ASSOCIATION

CAUSE NO. 70 199 0033 95K

NAURU PHOSPHATE ROYALTIES (TEXAS) INC.	BEFORE A PANEL OF ARBITRATORS HOUSTON, TEXAS
VS.	
DRAGO DAIC INTERESTS, INC.	PURSUANT TO THE RULES OF THE AMERICAN ARBITRATION ASSOCIATION

****

AMENDED DISSENT

****

I hereby amend my original dissent. I also respectfully dissent from the decision of the majority to deny the Motion to Reconsider filed by DDI, and the refusal of the majority to correct an obvious error in the Award. This arbitration panel lacks jurisdiction to grant relief not requested by any pleading, motion or prayer, and against non-parties who had not agreed to, had notice of, or participated in this arbitration process. Further, the majority has awarded relief on an issue that was not even part of the deliberation process of these arbitrators.

MOTION FOR RECONSIDERATION

Within thirty days of the Award in Arbitration DDI filed a Motion for Reconsideration alleging:

1. The arbitration lacks jurisdiction to determine the rights and liabilities of NPR, Drago Daic Trustee, and Montgomery 666 Ltd. as to the promissory note in the principal amount of eight million dollars.

2. The arbitration panel made an award regarding Utility Improvement expenditures that was not the relief requested by the parties or the relief provided by the Development Agreement.

I would grant the Motion for Reconsideration as to both the note and the Porter Mud award.

PORTER MUD

NPR filed this Complaint in Arbitration alleging breach of the Development Agreement and asking this arbitration panel to enforce the terms and conditions of that contract. The Award at page six, Section VII.C.5, awards $477,000.00 to NPR for "LOSS OF REIMBURSEMENT FROM 122 LOTS LOCATED IN PORTER MUD." DDI correctly points out to this panel that the Development Agreement sets out a specific remedy in the event reimbursements for "utility improvements" are less than seventy percent of construction costs. Both NPR and DDI agreed to these terms and these remedies, and the arbitration panel has not been asked by either party to go outside the contract to conjure up a remedy not agreed to by the parties.

Section 5.3 of the Development Agreement is entitled *M.U.D. PAYMENT* and it reads as follows:

> It is anticipated that certain drainage, wastewater treatment, water purification and other

> utility facilities (the "Utility Improvements") will be required to be constructed on the Property in connection with the Project. Developer expects that the Municipal Utility District ("M.U.D.") to be formed to operate such Utility Improvements will purchase the Utility Improvements at a price equal to seventy percent (70%) of the cost incurred in constructing such Utility Improvements. All costs incurred in connection with the construction and provision of the Utility Improvements less all monies paid by the M.U.D. for the Utility Improvements shall constitute Project Expenses. In the event the amount paid by the M.U.D. is less than 70% of the cost incurred in providing the Utility Improvements. Owners shall have the right to deduce and retain fifty percent (50%) of such shortfall from any distribution of Cash Flow next due Developer or any Affiliate of Developer (including any monies due Drago Daic, Trustee, as 50% holder of the note) under Section 5.1 whether such distributions constitute payment of principal under the Promissory Note or the Developer Fee. In no event shall the amount due Owner from Developer under this Section 5.3 be considered a Project Expense.

The Development Agreement not only sets out the *specific remedy* in the event reimbursement for Utility Improvements is less than seventy percent of the cost of the improvements, but it also states that these costs are to be *project expenses*. Section 1.23 (a), (1), also includes these expenditures in the definition of "Project Expenses", and Section 5.1 (b) provides that "all project expenses paid by Owner" are to be reimbursed from "Cash Flow and Fees." Further, the parties agreed that Developer had no liability

for such project expenses of the Owner unless and until the reimbursement was less than seventy percent of costs, and the sole method of Owners' recovery of Developers' fifty percent share of the loss in excess of seventy percent of recovery was for Owner to withhold the monies from "any distribution of cash flow next due Developer."

It is clear that the Award in Section VII.C.5 is for "utility improvements," and it cannot be called anything else. The Development Agreement provides that "utility improvements" are "project expenses" and that the *sole* provision for the recovery by Owner of "project expenses" is from "cash flow." NPR cannot recover these "project expenses" based on any failure by DDI to disclose that part of the Property was in the Porter MUD because all of the fraud allegations have been found against NPR. Also, NPR has a title policy which does not reveal that some of the property is in the Porter MUD, and NPR should be able to recover these costs from the insurer. Finally, this relief cannot be justified by calling it a recovery for "cost overruns" because the Development Agreement defines the expense as "project expenses", and the agreement does not provide for "projet expenses" of the Owner to ever be reimbursed by the Developer.

In conclusion, it is clear that the parties have not agreed to any other form of reimbursement of "project expenses" and, it is equally clear that this arbitration panel has no power to "create: a method of recovery that has not been agreed to or requested by the parties. Therefore, **the majority of this arbitration panel has exceeded its' jurisdiction by granting relief not requested, and by refusing to grant relief in accordance with the contract as plead and prayed for the by the parties.**

I would grant DDI's Motion for Reconsideration and remove the award of $477,000.00 for "Loss Of Reimbursement From 122 Lots Located In Porter MUD."

PROMISSORY NOTE

Section IV of the Arbitration Award is entitled: "DECLARATORY JUDGMENT REGARDING TERMINATION OF DEVELOPMENT AGREEMENT." The arbitration panel responded to a motion filed by NPR which plead and prayed that this panel find that it terminated the Development Agreement "with cause." However, the majority of this panel not only found the agreement was "properly terminated", and that "NPR has no further duties to DDI. . . . " but the majority also gratuitously found: **"NPR has no liability for payment of the eight million dollar promissory note executed by NPR and payable to Drago Daic, Trustee and Montgomery 666 LTD."**

The Motion for Declaratory Judgment did not request in pleadings or in prayer that the liability of NPR pursuant to the promissory note be determined by this arbitration panel. Further, the gratuitous language granting such relief was not in the early drafts of the Award. This particular relief found in the final draft went unnoticed by this arbitrator because it was not requested by the parties or discussed, deliberated or argued by the panel. Further, it was never called to my attention as something "new" that had been added without my knowledge or consent. Therefore, the final draft was signed and my dissent was filed without comment on the error of the majority in granting relief not requested against entities

that were not parties to this arbitration. If I had known the gratuitous relief had been added to the final draft of the Award I would have made my dissent known at that time. Therefore, I will deal with this error, address my reasoning, and discuss the controlling law in the following "Amended Dissent."

AMENDED DISSENT

The gratuitous award rendered by the majority is not merely a mistake of law or fact, but it is a manifest disregard of the law and a conscious disregard for the constitutional requirements of due process. From the beginning of this arbitration in May, 1995, to the final Award in February, 1996, there has been no pleading, motion, prayer or request by any party that this panel adjudicate the rights and liabilities of the parties pursuant to the eight million dollar promissory note. Also, Drago Daic Trustee and Montgomery 666 Ltd., the owners, holders, and payees under the note, were not provided notice of or made parties to the arbitration, and they have never agreed to have this arbitration panel determine their rights pursuant to the note.

The Development Agreement states on the front cover that it is between "NAURU PHOSHATES [sic] ROYALTIES (TEXAS), INC., a Delaware Corporation, and, DRAGO DAIC INTERESTS, INC., A Texas corporation." Page one of the agreement again states it is "between NPR ('Owners') and DDI ('Developer')," Drago Daic, Trustee, and Montgomery 666 Ltd. were not parties to this agreement, and the word "Sellers" is only mentioned two times in the entire agreement. The first paragraph

notes that Owner and *Sellers* (Drago Daic and Montgomery 666 Ltd.) entered into an earnest money contract for the purchase of the "Property" which is the subject property of the Development Agreement, and Section 5 provides for the method of payment of the eight million dollar promissory note by Owners to *Sellers*. The agreement is executed on page 68 for NPR by the President of the Corporation and the President of the country of Nauru, and for DDI by the President and by the General Counsel for DDI.

On page 69, the last page of the agreement (excluding attachments), appears the words: "With respect to Section 3.7 and Article 5:" Under those words "MONTGOMERY 666 LTD." is typed and below that appear the signatures of "Moses Calderon, General Partner," and "Drago Daic, Trustee." Section 3.7 of the Development Agreement provides for partial and full release of the Deed of Trust, and there is no "Article 5." However, *Section* 5 provides that payment to Sellers of money due under the terms of the promissory note shall come from "cash flow and fees."

Although these issues were never made a part of this arbitration process, and there was no evidence or argument to assist this writer in determining the intent of the parties or the legal consequences of the Sellers signatures on the last page of the Development Agreement, I believe simple logic will reveal the only reasonable conclusion. If the signatures of the general partner of Montgomery 666 Ltd. and Drago Daic Trustee on the last page indicate a participation in or approval of the Development Agreement, it can only infer an agreement or participation in those specific provisions under which their names appear to wit. "Section 3.7 and Article 5." Logic cannot be

stretched to assume the Sellers agreed to abide by any other provision of the agreement.

Section 13 of the Development Agreement is entitled "Dispute Resolution" and is the only provision dealing with the arbitration of any dispute between "Owner and Developer" arising out of the agreement. The usual "notice" provision is found in Section 14.4, and includes only the "Owner", "Developer", and their respective attorneys. There is no mention in Section 13 or in any other part of the Development Agreement of any provision to arbitrate disputes between "Owner and Sellers." Further, there has been no evidence, pleading, motion, request, prayer, or even argument that the Sellers approved of, were a part of, or agreed to be bound by, this arbitration process. Even if the majority of this panel made the quantum leap and held that Sellers agreed to arbitrate any dispute with Owners over the promissory note, they would also have to come to the inevitable conclusion that Sellers would then be indispensable parties and entitled to notice and an opportunity to participate in this arbitration process.

The majority of this panel has exceeded its' subject matter and personal jurisdiction because there are no pleadings or prayer asking this panel to determine the rights and liabilities of the Owner and the Sellers pursuant to the promissory note. See *Giamatteo v. Olney*, 794 S.W.2d 103, (Tex. App. Dallas, 1990 – no writ). In order for this award to stand, NPR must establish "as a matter of law" that a valid and enforceable "arbitration agreement" exists between NPR (buyer) and Drago Daic, Trustee, and Montgomery 666 Ltd. (sellers), 794 S.W.2d at page 105. The authority of arbitrators is derived solely from the

Arbitration Agreement and is limited to a decision of the matters submitted therein. See *Gulf Oil Corp. v. Guidry*, 327 S.W.2d 406, (Tex. 1959). The majority of this arbitration panel has intentionally and knowingly disregarded the law and exceeded their authority and jurisdiction.

By refusing to correct an obvious error of law, the majority of this panel has demonstrated an intent to ignore the clear and unambiguous law of this state. The movant in an arbitration is "not entitled to relief he never requested." *Fridl vs. Cook*, 908 S.W.2d 507, 515 (Tex. App. El Paso, 1995, writ req.). The Supreme Court of Texas has also specifically condemned arbitrators who "exceed their powers" by making awards that "fail to conform either to the parties' arbitration agreement or the relief sought," and have held that the courts have the power to vacate such awards. *Kline vs. O'Quinn*, 874 S.W.2d 776 (Tex. 1994). Also see Tex. Civ. Stat. Ann. Art 237, Sec. A(2) and (3). No party is entitled to receive relief that was not requested in pleadings or in prayer, and a judgment for relief that has not been plead cannot stand. *Birdwell v. Birdwell*, 814 S.W. 2d 223, 229 (Tex. App. Fort Worth, 1994). Further, a prayer for general relief is not sufficient to support an award for relief to which the other party was entitled to notice. *Baja Energy Inc. v. Ball*, 669 S.W.2d 836, 838-39, (Tex. App. Eastland, 1984, no writ). Not only does the law require a pleading to put the defendant on notice of the specific allegations against him, but the purpose of the prayer is to provide a second safeguard and "see that the defendant is not prejudiced by the assertion of some wholly unexpected theory of relief – one not presaged in the pleadings and justified by the proof." *Green Tree Acceptance Inc. vs. Pierce*, 768 S.W. 2d

416, 421 (Tex. App. Tyler, 1989, no writ). **For some inexplicable reason, the majority of this arbitration panel has "gratuitously" acted in a manner that is wholly inconsistent with law, logic, reason and equity.**

The most serious abuse of the law by the majority of this arbitration pane [sic] is the denial of due process to the Sellers who were not parties to the arbitration. Due process of law is a fundamental right which is protected by both Federal and State Constitutions. See U.S. Const. Amend. XIV, Sec.1 and Tex. Const. Art. 1 Section 19. The ultimate test of due process of law is "the presence or absence of rudiments of fair play long known to our law." *State v. Crank*, 666 S.W.2d 91 (Tex. 1984). To be denied notice and an opportunity to be present and cross-examine witnesses' and evidence against you and/or your property rights is a clear denial of the constitutional right to due process. The Texas Rules of Procedure also provide that no judgment may be rendered against a defendant unless upon service, or by acceptance or waiver of process, or upon appearance. Tex. R. Civ.P. Rule 124.

I find no joy in the strong language I have used in this dissent. However, I take great pride in the law and I took seriously the oath to protect and defend the laws of this State and the United States. It should be the primary goal of every attorney to defend those who have been denied the protection and safeguards that are fundamental to an orderly society. The actions taken by the majority in making this Award cannot be justified by any known application of law or of equity, and it is contrary to all logic and reasoning. I find the award to be arbitrary and capricious, and such a gross abuse of the law as to imply bad faith or failure to exercise honest judgment. This

arbitration panel has no jurisdiction to grant relief that has not been requested, or to take away the constitutionally protected rights of non-parties who have never agreed to, received notice of, been made parties to, or in any way participated in, this arbitration process.

I would grant the Motion to Reconsider and strike that portion of the Award which finds that NRP has no liability for payment of the eight million dollar note.

This Amended Dissent and Dissent from the majority denial of the Motion For Reconsideration is filed this 4th Day of April, 1996.

/s/ Ross A. Sears
JUDGE ROSS A. SEARS
ARBITRATOR

On this 4th day of April, 1996, before me personally appeared Judge Ross A. Sears, known to me to be the individual who executed the foregoing Amended Dissent in my presence and who acknowledged same before me.

/s/ Karen Smith
NOTARY PUBLIC, STATE OF TEXAS
[SEAL]
KAREN SMITH
MY COMMISSION EXPIRES
March 22, 1999

APPENDIX G

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 97-20279

NAURO PHOSPHATE ROYALTIES, INCORPORATED, (Texas)

Plaintiff-Appellee

v.

DRAGO DAIC INTERESTS INCORPORATED

Defendant-Appellant

Appeal from the United States District Court for the Southern District of Texas, Houston

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ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(Opinion 3/31/98, 5 Cir., ___, ___ F.3d ___)

(Filed Apr. 29, 1998)

Before HIGGINBOTHAM and STEWART, Circuit Judges, and WALTER* District Judge.

PER CURIAM:

(X) The Petition for Rehearing is DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on

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*District Judge of the Western District of Louisiana, sitting by designation.

Rehearing En Banc, (FED. R. APP. P. and 5TH CIR. R. 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) The Petition for Rehearing is DENIED and the court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service not having voted in favor, (FED. R. APP. P. and 5TH CIR. R. 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Illegible
United States Circuit Judge

APPENDIX H

* * *

[60] **SECTION 11 - TERMINATION**

Unless sooner terminated as provided herein, this Agreement shall be for an initial term commencing on the Closing Date under the Purchase Agreement and terminating upon completion of the last Phase of the Project. Notwithstanding the foregoing, this Agreement may be terminated by Owner in its sole discretion, with or without cause, at any time upon thirty (30) days prior written notice to Developer.

Upon termination of this Agreement, with or without cause, Developer and Owner shall, within fifteen (15) days of such termination, each appoint an independent qualified real estate appraiser with at least ten (10) years' experience in the Houston, Texas area and the two appointed appraisers shall, within fifteen (15) days of their appointment, select a third independent real estate appraiser with similar qualifications. Each appraiser shall conduct such investigations as the appraiser may deem appropriate and shall furnish to Owner and Developer within thirty (30) days of its appointment a written appraisal setting forth the fair market value of Developer's economic interest in the Project ("Developer's Interest"). The Developer's Interest shall equal twenty-two and one-half percent (22½%) of the excess of the fair market value of the Property at the time of the appraisal over the sum of $13,000,000 and all Unreimbursed Project Expenses incurred as of such date. The Developer's Interest shall not include any amount due or to be paid under the Promissory Note. The two appraisals closest in [61]

value shall be averaged and the result shall be deemed the fair market value of the Developer's Interest.

In the event this Agreement is terminated by Owner without cause, the Developer's Interest shall be paid to Developer within forty-five (45) days of the appraisers' determination of the value of the Developer's Interest. In the event this Agreement is terminated by owner with cause, the Developer's Interest shall be distributed to Developer in cash at such time and to the extent Developer would have received its Development Fee pursuant to Section 5.1(e) had it continued as the developer of the Project, it being understood and agreed that in no event shall the amount of the Developer's Interest paid to Developer exceed the amount of the Developer's Fee which would have been paid to Developer had it continued as the developer of the Project. The termination of this Agreement, with or without cause, shall in no way accelerate or otherwise modify Sellers' right to receive payments of principal under the Promissory Note in accordance with the priority for Cash Flow distribution as set forth in Section 5.1. Owner shall have the right to offset against any monies to be paid Developer pursuant to Section 5 or this Section 11 any amounts due Owner from Developer or in controversy between Owner and Developer; provided, that Owner shall deposit such offset amounts into escrow pending resolution of any disputes relating thereto and any interest earned on such escrow funds shall be for the benefit of the prevailing party. Nothing in this Section 11 shall be construed to limit the right of Owner or Developer to pursue any rights or remedies available [62] to it, in law or in equity, for the other party's breach of this Agreement.

Notwithstanding anything contained in this Agreement to the contrary, in the event Owner exercises its right to sell the Property pursuant to Section 17 of the Purchase Agreement, this Agreement shall automatically terminate and be of no further force and effect, and Developer shall have no right to receive any Development Fees or other compensation from Owner hereunder, and the rights and obligations of Owner and Developer shall be governed solely by the terms of the Purchase Agreement.

SECTION 12 – INDEMNITY

12.1 By Developer. Developer hereby agrees to defend, indemnify and hold Owner harmless from and against: all claims asserted by any third party (including a governmental authority), including all costs, damages, fines or penalties (including, without limitation, attorneys' fees) resulting from such claims, where the claims arise out of or are based upon Developer's breach of this Agreement, negligence, willful misconduct or violation of law.

12.2 By Owner. Owner hereby agrees to defend, indemnify and hold Developer harmless from and against: all claims asserted by any third party (including a governmental authority), including all costs, damages, fines or penalties (including, without limitation, attorneys' fees) resulting from such claims, where the claims arise out of or are based upon Owner's gross negligence or willful misconduct.

[63] **SECTION 13 – DISPUTE RESOLUTION**

Any dispute, controversy or claim arising out of or in connection with or relating to this Agreement or any breach or alleged breach hereof, shall, upon the request of any party involved, be submitted to and settled by arbitration in Houston, Texas pursuant to the rules then in effect of the American Arbitration Association. The party to this Agreement requesting arbitration shall submit written notice to the other party hereto of such request. Upon receipt of such notice, Owner and Developer shall within twenty (20) days each appoint an arbitrator and the two arbitrators so appointed shall within an additional fifteen (15) days appoint a third presiding arbitrator; provided, however, if the amount in dispute is less than Fifty Thousand Dollars ($50,000.00), the Owner and Developer may consent to arbitration by (and the terms of selection for) a single neutral arbitrator. Any award rendered shall be final and conclusive upon the parties and a judgment thereon may be entered in the appropriate court of the forum, state or federal, having jurisdiction. The expenses of the arbitration shall be borne equally by the parties to the arbitration. No arbitration shall be commenced after the date when institution of legal or equitable proceedings based upon such subject matter would be barred by the applicable statute of limitations. Notwithstanding anything to the contrary contained in this Section or elsewhere in this Agreement, (i) Owner shall not be precluded hereby from bringing an action for specific performance in the event of the [64] failure by Sellers or Developer, as the case may be, to convey the Property to Owner or to deliver the Partial Release or Full Release described in Sections 3.7 and 5.4

hereof, and (ii) any party hereto may seek injunctive relief without first submitting the subject dispute to arbitration.

SECTION 14 – MISCELLANEOUS PROVISIONS

14.1 Binding Effect. The provisions of this Agreement shall be binding upon and inure to the benefit of the parties and their respective successors and permitted assigns.

14.2 Time of Essence. The parties acknowledge that time is of the essence of this Agreement. With respect to each performance obligation contemplated herein for which no time period or deadline is expressly provided, the responsible party shall discharge such obligation with all reasonable promptness and timeliness under the applicable circumstances.

14.3 Force Majeure. No party to this Agreement shall be deemed in breach or violation of any covenants, terms or provisions of this Agreement for so long as and to the extent that such party's performance of its obligations is prevented by force majeure or other causes and circumstances beyond the reasonable control of the party, including, without limitation, delay by or in consequence of any acts of God, acts of the public enemy, wars, blockades, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storm washouts, arrests, and restraints of rulers and people, civil disturbances, explosions, strikes, and any other cause of the kind enumerated

* * *

[68] thereby, and each term or provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

14.10 Assignment. Neither party shall assign all or any portion of its interest in this Agreement to any other entity or person without the prior express written consent of the other party.

14.11 Integration. This Agreement contains the entire agreement and understanding of the parties with respect to the subject matter hereof, and supersedes all prior and contemporaneous agreements between them with respect hereto.

14.12 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Texas.

IN WITNESS WHEREOF, the parties have executed this Agreement to be effective on the date first set forth above.

DRAGO DAIC INTERESTS, INC.

By: /s/ Illegible
Name: _____
Title: _____

By: /s/ Illegible
Name: _____
Title: _____

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.

By: /s/ Illegible
Name: _____
Title: _____

By: /s/ Illegible
Name: _____
Title: _____

[69] With respect to Section 3.7 and Article 5:

Attest:

MONTGOMERY 666, LTD.

By: /s/ Illegible
Name: _____
Title: _____

By: /s/ Illegible
Name: _____
Title: _____

By: /s/ Illegible
Name: _____
Title: _____

By: /s/ Draco Daic
Draco Daic,
Trustee

APPENDIX I

NOT NEGOTIABLE

PROMISSORY NOTE

$ (US) 8,000,000.00

Houston, Texas
January 22, 1990

RECITALS

NAURU PHOSPHATE ROYALTIES (Texas), Inc., a Delaware corporation ("Maker"), and **DRAGO DAIC, Trustee,** a Texas resident and **MONTGOMERY 666, LTD.**, a Texas limited partnership (collectively "Holder"), have entered into that certain Earnest Money Contract dated January ___, 1990 (the "Earnest Money Contract") and have today closed that transaction set forth in the Earnest Money Contract. This Promissory Note ("this Note") is given to evidence the conditional obligation of Maker to pay payments of principal totaling up to $8,000,000.00 without interest thereon to Holder (the "Indebtedness"), subject to certain set-off rights of Maker, all as specified in the Earnest Money Contract and, by reference therein, Section 5 of the Development Agreement between Drago Daic Interests, Inc. and Maker dated as of January 22nd, 1990 (the "Development Agreement"). The terms of the Earnest Money Contract and the Development Agreement are hereby incorporated into this Note as if fully set forth in this Note.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged by Maker.

SECTION 1 – PAYMENT OBLIGATION

Maker hereby promises to pay to Holder (or upon an assignment of this Note to any successor holder of this Note) the Indebtedness, when and as required under the terms of this Note (which incorporates the payment terms of the Earnest Money Contract and Development Agreement). Payments shall be made to Holder at 14405 Walters Road, Suite 900, Houston, Texas 77014 by means of wire transfer or certified check.

SECTION 2 – APPLICATION OF PAYMENTS

Each payment made by Maker under the terms of this Note shall be applied to the principal due under this Note. Maker shall under no circumstances be obligated to pay interest on the Indebtedness.

SECTION 3 – PREPAYMENTS

Maker has the right, without the Holder's prior consent, without any penalty, and without any advance notice, to prepay all or any amount owed under the terms of this Note. Any such prepayments shall be applied first to the principal payment due in the year when paid, then to any accrued but unpaid principal, and then to the principal due in each succeeding year.

SECTION 4 – DEFAULT

4.1 Event of Default

Any of the following shall constitute an Event of Default by Maker under this Note:

4.1.1 The failure by Maker to pay, when due, any principal due under this Note and such failure is not cured within thirty (30) days after written notice from Holder of such default.

4.1.2 The failure by Maker to perform when due Maker's obligations under the Deed of Trust referred to in Section 5 below (a) which is not cured within ninety (90) days after written notice of such failure from Holder or (b) the cure of which is not commenced within ninety (90) days after written notice thereof from Holder and continued diligently until completed if such failure cannot reasonably be cured within ninety (90) days.

4.1.3 The filing by Maker of a petition in bankruptcy, either voluntary or involuntary; Maker seeking any form of protection under state or federal laws applicable to insolvent debtors; Maker making an assignment of assets for the benefit of creditors; or the appointment of a receiver over any of Maker's assets or property.

4.2 Remedies

In the case of an Event of Default under Section 4.1.1, Holder may, in its sole discretion and provided Drago Daic Interests, Inc. ("Developer") is not then in default under the Development Agreement, declare immediately due and payable the entire principal balance hereof, and Holder shall further be entitled to pursue any remedies available to it under the Deed of Trust. In the case of an Event of Default under Section 4.1.2 or 4.1.3, Holder shall be entitled to an action for damages or any other remedy available to it at law or in equity, but Holder shall not be

entitled to accelerate the principal balance under this Note, or to enforce the power of sale under the Deed of Trust prior to a final judgment by a court of competent jurisdiction to the extent such court shall grant a remedy of foreclosure. Notwithstanding the foregoing, in no event shall an Event of Default under this Note affect Developer's or Maker's rights or remedies under the Development Agreement.

4.3 Collection Costs

Maker promises to pay all costs, expenses and reasonable attorneys' fees incurred by Holder in the exercise of any remedy (with or without litigation), in the collection of the Indebtedness, in any foreclosure of the Deed of Trust or the realization upon any other security securing this Note, in protecting or sustaining the lien or priority or the Deed of Trust but only where the priority is jeopardized by documents signed by Maker and purporting to create a superior lien, any appeal from or petition for review of any of the foregoing, in which the Holder ultimately prevails. If a judgment is obtained thereon which includes an award of attorneys' fees, such attorneys' fees, costs and expenses shall be in such amount as the court shall deem reasonable.

SECTION 5 – DEED OF TRUST

This Note is secured by that certain Deed of Trust dated January ___, 1990, with Maker as Grantor and Holder as Beneficiary (the "Deed of Trust"). The Deed of Trust is a first lien against and upon the real property

described as the Property in the Earnest Money Contract (the "Property").

SECTION 6 – NON-RECOURSE

This Note is non-recourse; that is, Holder may exercise all of its rights and remedies under the Deed of Trust but may not obtain a deficiency judgment against Maker and may not waive the Deed of Trust and sue on this Note, however to the extent necessary or convenient to exercising a remedy under the Deed of Trust, Holder may sue on this Note so long as Holder does not seek a deficiency judgment and Holder hereby waives any deficiency judgment.

SECTION 7 – SATISFACTION

This Note shall be deemed void and of no further force and effect upon the earliest to occur of the following events: (a) sale of the Property pursuant to Section 17 of the Earnest Money Contract, (b) sale of the Property pursuant to Section 5.4 of the Development Agreement, (c) sale of all of the Lots (as that term is defined in the Development Agreement), or (d) payment in full of the Indebtedness.

SECTION 8 – WAIVERS

Maker hereby waives presentment, demand of payment, notice of dishonor, protest, and notice of nonpayment, and any and all other notices and demands whatsoever, except for those set forth in Section 4.1 above. No covenant, condition, right or remedy in this

Note may be waived or modified orally, by course of conduct or previous acceptance or otherwise unless such waiver or modification is specifically agreed to in writing executed by the Holder.

SECTION 9 – NOTICES

Any notice required or permitted to be given under this Note shall be given as specified in the Earnest Money Contract.

SECTION 10 – CONSTRUCTION

This Note shall be governed by and construed in accordance with the laws of the State of Texas. This Note and all security documents executed in connection with this Note have been reviewed and negotiated by Maker and Holder at arms' length with the benefit of legal counsel and shall not be construed against either party. The titles and captions in this Note are inserted for convenience only and in no way define, limit, extend, or modify the scope or intent of this Note.

SECTION 11 – PARTIAL INVALIDITY

If any section or provision of this Note is declared invalid or unenforceable by any court of competent jurisdiction, said determination shall not affect the validity or enforceability of the remaining terms hereof. No such determination in one jurisdiction shall affect any provision of this

Note to the extent it is otherwise enforceable under the laws of any other applicable jurisdiction.

MAKER:

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.,
a Delaware corporation

By: /s/ Illegible
Name: /s/ Chairman T.C. Moses
Title: President

APPENDIX J

Rule 6 of the Commercial Rules of Arbitration of the American Arbitration Association

6. Initiation under an Arbitration Provision in a Contrast Arbitration under an arbitration provision in a contrast shall be initiated in the following manner:

a. the initiating party (hereinafter claimant) shall, within the time period, if any, specified in the contrast(s), give written notice to the other party (hereinafter respondent) of its intention to arbitrate (demand), which notice shall contain a statement setting forth the nature of the dispute, the amount involved, if any, the remedy sought, and the hearing locale requested, and

b. shall file at any regional office of the AAA three copies of the notice and three copies of the arbitration provisions of the contract, together with the appropriate filing fee as provided in the schedule on page 27.

The AAA shall give notice of such filing to the respondent or respondents. A respondent may file an answering statement in duplicate with the AAA within ten days after notice from the AAA, in which event the respondent shall at the same time send a copy of the answering statement to the claimant. If a counterclaim is asserted, it shall contain a statement setting forth the nature of the counterclaim, the amount involved, if any, and the remedy sought. If a counterclaim is made, the appropriate fee provided in the schedule on page 27 shall be forwarded to the AAA with the answering statement. If no answering statement is filed within the stated time, it will be treated as a denial of the claim. Failure to file an answering statement shall not operate to delay the arbitration.

(2)

Supreme Court, U.S.
FILED
AUG 27 1998
OFFICE OF THE CLERK

No. 98-191

In The

Supreme Court of the United States

October Term, 1997

DRAGO DAIC INTERESTS, INC.,

Petitioner,

vs.

NAURU PHOSPHATE ROYALTIES (TEXAS), INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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PARENT COMPANIES, AND NONWHOLLY OWNED SUBSIDIARIES

Respondent Nauru Phosphate Royalties (Texas), Inc.'s parent company is Nauru Phosphate Royalties, Inc., a Delaware corporation. Respondent has no nonwholly owned subsidiaries.

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United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29 (1987) 6

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Respondent Nauru Phosphate Royalties (Texas), Inc. ("Nauru") requests that the Court deny the petition for writ of certiorari seeking review of an opinion of the United States Court of Appeals for the Fifth Circuit. The Fifth Circuit's opinion is reported at 138 F.3d 160, *petition for cert. filed*, 67 U.S.L.W. 3105 (U.S. July 27, 1998) (No. 98-191).

Nauru's citations wili be to the published Fifth Circuit opinion, and to the record below, because the Appendices attached to the petition for writ of certiorari contain errors, and accordingly, Nauru is not confident of their accuracy. For instance, on page 165 of the Fifth Circuit opinion, the court states:

> Not only does it fully incorporate by reference the Development Agreement, the Promissory Note is explicitly referenced throughout the Development Agreement.

By virtue of the margin placement, Appendix A incorrectly indicates that this statement is language in the Promissory Note (Appendix A at 8-9), rather than an observation by the Fifth Circuit. (*Nauru Phosphate Royalties (Texas), Inc. v. Drago Daic Interests, Inc.*, 138 F.3d at 165).

Likewise, Appendix E incorrectly substitutes the word "not" for the correct word "no," in the Award of Arbitrators (Appendix E at 77). The correct language is:

> NPR has no liability for payment of the eight million dollar promissory note. . . .

(R. 37, Ex. A).

STATEMENT OF THE CASE

In January 1990, Nauru entered into a sale and development agreement with three parties, Drago Daic Interests, Inc. ("DDI"), Drago Daic, Trustee ("Daic Trustee"), and Montgomery 666, Limited ("M-666"). Nauru purchased 668 acres of land in Montgomery County, Texas from Daic Trustee and M-666 in order to develop the property into a residential housing subdivision complete with country club, golf course and other amenities.

Nauru paid $5 million in cash to Daic Trustee and M-666 for the 668 acres (Arb. Tr. Vol. 26, Vol. 1 at 00049-00248), and accordingly DDI's claim (Petition at 20) that Daic Trustee and M-666 have not been paid for the land is incorrect. Nauru also executed a contingent, non-recourse $8 million Promissory Note to Daic Trustee and M-666 (the "noteholders"), which would only be payable if the project was successful, as defined by a formula contained in the agreement, *i.e.*, generally, if revenues exceeded expenditures in any given year. (Arb. Tr. Vol. 26, Vol. 1 at 00108-00115, 00142-00220).

Drago Daic, "the man behind" DDI, Daic Trustee and M-666, negotiated the sale and development agreement on behalf of all three parties. (138 F.3d at 166; Arb. Tr. Vol. 1, Response of DDI, Ex. A at 2). Drago Daic insisted that DDI, his wholly owned company, be named the developer of the project, so that DDI could control the project and ensure that the Promissory Note would be paid to the noteholders. (138 F.3d at 165-66).

The sale and development agreement was evidenced by several documents, including an Earnest Money Contract, the conditional $8 million Promissory Note, a Deed of Trust, a Warranty Deed with Vendor's Lien, and a Development Agreement. The Promissory Note fully incorporates the terms

of the Earnest Money Contract and the Development Agreement. (138 F.3d at 165). The signature of the noteholders on the Development Agreement, with a specific reference to two provisions in the Development Agreement, is an affirmation that the noteholders will abide by or comply with the actions required of them by those provisions, and is not a limitation as claimed by DDI. (Petition at 3, 13). As observed by the Fifth Circuit, the noteholders' attempt to enforce other provisions of the Development Agreement binds them to its terms. (138 F.3d at 167).

DDI developed the property for approximately five years. Although certain amenities were constructed, the project was a financial disaster for Nauru. Nauru spent more than $30 million in developing the property, and received only approximately $1 million in return. (R. 14 at 4). DDI's observation (Petition at 4), that Nauru became dissatisfied with costs and expenses, is a gross understatement.

In 1995, as a result of Nauru's dissatisfaction with DDI's management of the project, Nauru terminated DDI as developer, and instituted an arbitration proceeding. DDI's suggestion (Petition at 5) that the noteholders instituted a lawsuit on the Promissory Note in Texas District Court in Montgomery County, Texas, prior to Nauru terminating DDI and filing the arbitration, is a misstatement. Nauru terminated DDI and filed the arbitration prior to the noteholders filing a separate suit in Montgomery County. (Arb. Tr. Vol. 7, Vol. 25, at 33-34, 41). DDI's claim that the noteholders continued to prosecute their state court lawsuit throughout the arbitration (Petition at 6), is likewise a misstatement. The state court judge stayed the noteholders' lawsuit during the pendency of the arbitration. (Arb. Tr. Vol. 5, Vol. 14, at 20-21).

The arbitration hearing lasted approximately four months, and consisted of 55 days of testimony. Thirty-six witnesses

testified and thousands of pages of documents were introduced as exhibits. (Arb. Tr. Vols. 2-15). On February 9, 1996, the arbitrators agreed with Nauru that DDI was responsible for the financial failure of the development, by finding that DDI committed 13 material breaches of the Development Agreement. Nauru then filed an action in federal District Court to confirm the arbitration award, which resulted in the decisions of the District Court and Fifth Circuit below.

ARGUMENT

I.

REASONS FOR DENYING THE WRIT

The Fifth Circuit's decision is correctly decided, based on well established authority, and is not in conflict with the decisions of other Circuits, or with the decisions of the United States Supreme Court.

II.

DDI HAS MADE MISSTATEMENTS OF FACT AND LAW

In the Statement of the Case above, Nauru has pointed out inaccuracies in DDI's petition. But there are more. Pursuant to United States Supreme Court Rule 15.2, Nauru brings to the Court's attention additional misstatements of law and fact contained in the petition.

A. Promissory Note payments were legally dependent on DDI's performance as developer of the project.

DDI claims that the Promissory Note obligations were not legally dependent on DDI's performance as developer, that

certain contractual provisions provide otherwise, and therefore that the Fifth Circuit's decision is in manifest disregard of the law. (Petition at i, 4, 9, 15, 20). These claims are incorrect.

The Fifth Circuit properly determined that the Development Agreement had to be performed by DDI without material breach in order for the noteholders to be paid. (138 F.3d at 165). Accordingly, the Promissory Note is an interest contingent upon faithful performance of the contract by DDI. (138 F.3d at 167). These determinations by the Fifth Circuit are supported by provisions in the Promissory Note and the Deed of Trust. These provisions, Section 4.2 in the Promissory Note and Section 7 in the Deed of Trust, provide that if DDI is in default under the Development Agreement, then the noteholders cannot accelerate the Promissory Note or pursue any remedies under the Deed of Trust. (Arb. Tr. Vol. 26, Vol. 1 at 00108-00141). Because the Promissory Note is a non-recourse note, the noteholders can only enforce the Promissory Note by foreclosing on the property under the rights provided in the Deed of Trust. The noteholders therefore cannot recover under the Promissory Note if DDI is in default under the Development Agreement.

These contract terms are consistent with the background of the sale and development agreement. Payment of the Promissory Note was never an absolute obligation, but was dependent upon a successful development of the project. In effect, the parties to the sale and development agreement agreed, at the outset, that if the project was unsuccessful, then the Promissory Note would not be paid. Because DDI, the entity that Drago Daic insisted be placed in charge of the project to ensure that the Promissory Note would be paid, was responsible for the financial failure of the development, it follows that Nauru's liability on the Promissory Note would terminate.

In an attempt to contest these clear provisions in the Promissory Note and Deed of Trust, DDI cites a provision in

the Development Agreement. The arbitrators had all of these contractual provisions before them, including the provision DDI now relies upon, and concluded that Nauru has no liability under the Promissory Note. It is well settled that a court "may not reconsider an award based on alleged errors of fact or law or misinterpretation of the contract." *Exxon Corp. v. Baton Rouge Oil & Chemical Workers Union*, 77 F.3d 850, 853 (5th Cir. 1996) (citing *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 36 (1987)); *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1320 (5th Cir. 1994) ("We must sustain an arbitration award even if we disagree with the arbitrator's interpretation of the underlying contract as along [sic] as the arbitrator's decision 'draws its essence' from the contract."). All doubts are resolved in favor of the validity of the arbitration award. *Dole Ocean Liner Express v. Georgia Vegetable Co.*, 84 F.3d 772, 775 (5th Cir.), *opinion modified on other grounds*, 93 F.3d 166 (5th Cir. 1996). Therefore, DDI's arguments regarding the interpretation of an isolated contract provision is not an issue this Court can or should reach.

B. The Promissory Note issue was before the arbitration panel, and the noteholders were on notice thereof.

DDI also misstates the facts and law when it claims that the Promissory Note issue was not before the arbitration panel, and that the noteholders had no notice that the promissory note issue could be decided by the arbitrators. (Petition at i, 11-12, 17-18).

The issue of liability on the Promissory Note was raised in the arbitration by both pleadings and evidence. The Fifth Circuit correctly found that Nauru's demand for arbitration made liability on the Promissory Note an issue before the arbitration panel. (138 F.3d at 165). In DDI's responsive pleading, DDI claimed that Nauru was liable under the Promissory Note, based

on the claim that Nauru breached the Development Agreement. (Arb. Tr. Vol. 1, Response of DDI, Ex. A at 9). Witnesses for both parties testified in the arbitration about liability under the Promissory Note. A witness for Nauru testified that no money was due under the Promissory Note (Arb. Tr. Vol. 5, Vol. 16 at 184-185), and a witness for DDI testified that the Promissory Note could have been paid but for Nauru's acts (Arb. Tr. Vol. 13, Vol. 48 at 274-275). Because the issue of liability under the Promissory Note was raised by the pleadings of both parties, and because the issue of liability under the Promissory Note was disputed in testimony before the arbitrators, the arbitrators had authority to decide the issue.

The Fifth Circuit also correctly noted that the noteholders had notice that liability on the Promissory Note would be resolved by the arbitration panel. (138 F.3d at 166). The District Court found that Drago Daic,"the man behind" DDI and the noteholders, fully participated in the arbitration. (138 F.3d at 166). Their notice is further evidenced by a February 9, 1995 letter, which was signed by all three parties, DDI, Daic Trustee and M-666, and which was filed and made a part of DDI's pleadings in the arbitration. (Arb. Tr. Vol. 1, Response of DDI, Ex. A). In this letter, all three parties, DDI and the noteholders, asserted that Nauru was liable to the noteholders under the Promissory Note for its alleged breaches of the Development Agreement. DDI then attempted to prove in the arbitration that Nauru materially breached the Development Agreement. It is not difficult to understand why the arbitrators found no liability under the Promissory Note, when they determined that Nauru did not materially breach the Development Agreement.

C. DDI and the noteholders have related and congruent interests, and the decision binding the noteholders is based on recognized authority.

DDI claims that the Fifth Circuit cited no recognized basis for binding the noteholders, that DDI and the noteholders do not have related or congruent interests, that their rights are not legally derivative, and that the relationship between DDI and the noteholders does not constitute privity. (Petition at 12, 14-15). These claims are misstatements of fact and law.

The Fifth Circuit has cited a number of recognized bases for binding the noteholders, including the determination that the noteholders are third party beneficiaries (138 F.3d at 166), the fact that the broad arbitration clause was intended to reach all aspects of the relationship between the parties, including liability on the Promissory Note (138 F.3d at 165), the noteholders' attempts to enforce the agreement containing the arbitration clause (138 F.3d at 167), and the fact that the noteholders and DDI had related and congruent interests which were properly advanced and adequately represented during the arbitration (138 F.3d at 166-67).

The Fifth Circuit and the District Court found that the interests of DDI and the noteholders were related, congruent, similar, and the same. (138 F.3d at 166-67). The Fifth Circuit further determined that the interests of the noteholders were adequately represented by DDI, and that the record established that there was such an identity of interest that it was fair and appropriate to bind the noteholders. (138 F.3d at 166-67).

The evidence of related and congruent interests is overwhelming. In correspondence to the President of the Republic of Nauru, DDI asserted that the issue of the $8 million

Promissory Note must be resolved. (Arb. Tr. Vol. 30, Vol. 18 at 006656-006657). In the February 9, 1995 letter attached to DDI's pleadings in the arbitration, DDI, Daic Trustee and M-666 stated that one of the primary interests of DDI was to ensure that the Promissory Note would be paid. (Arb. Tr. Vol. 1, Response of DDI, Ex. A at 5). They further claimed in this letter that Nauru's actions were breaches of both the Development Agreement and the Promissory Note, and that those actions had resulted in damage to the noteholders. (138 F.3d at 167; Arb. Tr. Vol. 1, Response of DDI, Ex. A at 9). Accordingly, these three parties had a common interest in proving common questions of law and fact, *i.e.*, that Nauru breached the Development Agreement. Furthermore, the fact that the noteholders have attempted to make res judicata and collateral estoppel claims against Nauru based upon certain findings made in the arbitration (Appellant's Brief before the 5th Circuit at 27), is clear evidence that the noteholders claim to have derivative rights from DDI. The assertion of derivative rights, and an interest in proving common question of law and fact, establish that DDI and the noteholders are in privity. That both the Promissory Note and Deed of Trust provide that the noteholders cannot enforce their lien while DDI is in default under the Development Agreement, is also evidence of derivative rights and related and congruent interests. If DDI and the noteholders did not have related and congruent interests, then DDI would not be filing this petition and objecting in this Court to the Fifth Circuit's determination that the noteholders are bound by the arbitration findings.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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